Dissenting Views on S. 256

Reform of the bankruptcy system, and the principle that every debtor should repay as much of her debt as she can reasonably afford, is a sound and uncontroversial idea. Were the legislation reported by the Judiciary Committee to bear any remote relationship to that laudable goal, this legislation would be wholly uncontroversial. Instead, by pressing legislation that is unbalanced and tilted toward specific special interest groups, the proponents of S. 256 have created a bill that would: impose monumental costs on the parties in the bankruptcy system, including the government; subject the "honest but unfortunate debtor" to coercion and loss of their legal rights; force businesses into unnecessary liquidation; and favor certain creditors over others.[1]

It is a stark fact that the bankruptcy filing rate has almost doubled during the last decade. Nonetheless, debtors filed just under 1.6 million bankruptcy cases last year,[2] a decline in total bankruptcy filings nationally from 2003 of 3.8%.[3] The bill's sponsors view the long-term increase as evidence of widespread abuse of the bankruptcy system by people who otherwise would be in a position to pay their debts. Bankruptcy, the bill's sponsor says, has become a system "where deadbeats can get out of paying their debt scott-free while honest Americans who play by the rules have to foot the bill."[4]

The bankruptcy filing rate is a symptom. It is not the cause. While some people abuse the bankruptcy system, more than 90 percent of debtors file for bankruptcy due to unemployment or underemployment, an illness or accident, or divorce. The bulk of the remainder suffered from other legitimate difficulties, including activation for military service, being a victim of crime or natural disasters, or a death in the family .... an independent study on the subject found that less than four percent of debtors who filed under Chapter 7 (where unsecured debt is discharged) could possibly repay *any* of their unsecured debt under Chapter 13.[5]

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[1] Local Loan v. Hunt, 292 U.S. 234, 244 (1934). "One of the primary purposes of the bankruptcy act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.' The purpose of the act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Id.* (Citations omitted).

[2] ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, BANKRUPTCY STATISTICS FOR CALENDAR YEAR ENDING ON DECEMBER 31, 2004.

[3] ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, BANKRUPTCY STATISTICS FOR CALENDAR YEAR ENDING ON DECEMBER 31, 2003 *available at* http://www.uscourts.gov/bnkrpctystats/statistics.htm#calendar.

[4] Press Release, Office of Senator Charles Grassley, Grassley Renews Effort to Reform Bankruptcy Code (February 2, 2005).

[5] Letter from Martin Eakes, CEO, Self-Help Credit Union; Jim Blaine, State Employees' Credit Union, North Carolina; Terry D. Simonette, President & CEO, NCB Development Corporation; Calvin Holmes, Executive Director, Chicago Communit6y Loan Fund; Elsie Meeks, Executive Direct, First Nations Oweesta Corporation; Ceyl Prinster, Executive Director, Colorado Enterprise Fund; Bill Edwards, Executive Director, Association of Enterprise Organizations; Mark Pinsky, National Community Capital Association; John Herrera, Board Chair, Latino Community Credit Union; Fran Grossman, Executive Vice President, ShoreBank Corporation; Kerwin Tesdell,

Our concerns regarding this legislation are procedural as well as substantive. The House Judiciary Committee has held no hearings on this legislation in this Congress.[6] The Subcommittee on Commercial and Administrative Law has not considered the bill. Additionally, Chairman Sensenbrenner made it abundantly clear that, although regular order would be followed, in Full Committee, it would be regular order in name only. The votes, and the result, were preordained. No amendments were permitted, and none would receive consideration regardless of their merit.[7]

The single Senate Judiciary Committee hearing on S. 256 shed light on the major factor now driving people into bankruptcy: increasingly high medical expenses. A joint study of bankruptcy filings by researchers at Harvard Medical School and Harvard Law School revealed that roughly half of all bankruptcies filed in 2001 were caused, at least in part, by illness or medical debts.[8] Remarkably, 75 percent of bankruptcy filers with medical expenses had health insurance at the onset of their bankrupting illness. However, a significant number experienced gaps in coverage and high out-of-pocket costs, particularly for prescription drugs.

In the eight years since the credit industry first came to Congress seeking relief from the rising rate of personal bankruptcy filings, the extension of credit has not been curtailed nor have the industry's profits been diminished due to bankruptcy filings. Instead, credit card solicitations have doubled to five billion a year.[9] The bill still ignores the problem of the abuse of consumers by credit card companies.

While bankruptcy filings have increased 17 percent in the last eight years, credit card profits have increased 163 percent – from \$11.5 billion to \$30.2 billion.[10] The cost of late and other penalty fees assessed by credit card companies have doubled in the last decade and now are more quickly levied (payments arriving after a certain hour on the due date are now considered late). Even more damaging have been the accompanying penalty rates. These rates jump from usually zero percent to a range of 22-29 percent, are retroactive to the entire balance, and, thanks to "universal default" policies, now create a domino effect on the consumer's financial

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CEO, Community Development Venture Capital Associationto Hon. Dennis Hatert, Speaker and Hon. Nancy Pelosi, Minority Leader, U.S. House of Representatives (Mar. 14, 2005)(citations omitted)(on file with minority staff).

[6] The most recent hearing was held on March 4, 2003.

[7] In his opening statement during the March 16, 2005, markup, the Chairman stated "[i]t's no secret that I will strongly encourage Members of this Committee to vigorously oppose all amendments to S. 256 as passed by the Senate based on this extensive record . . . . I will, accordingly, urge my colleagues to report this bill without amendment."

[8] David U. Himmelstein et al., *Marketwatch: Illness and Injury as Contributors to Bankruptcy*, W5 HEALTH AFF. 63, 63 (2005) *at* www.healthaffairs.org.

[9] Kate Fitzgerald, *Mail Mania*, CREDIT CARD MGMT., Dec. 2004, at 20. (expecting that credit card issuers will mail a record \$5.4 billion solicitations in 2004).

[10] *Bankruptcy Reform: Hearing on S. 256 Before the Senate Comm. on the Judiciary*, 109th Cong. (Feb. 10, 2005) (statement of Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School) (citing CardWEb.com, Inc./RAM Research Group Frederick, MD *available at* www.cardweb.com).

situation.[11] Additionally, the average late fee in 2003 for a late payment on a credit card was $29.

Proponents of the legislation say that the bill will put pressure only on the families that have the ability to repay. In fact, the weight of the evidence demonstrates that the legislation will increase the cost of bankruptcy for every family, and it will decrease the protection of bankruptcy for every family, regardless of income or the cause of financial crisis. There are provisions that will: force many honest debtors unnecessarily out of chapter 7, make Chapter 13 impossible for many of the debtors who file today, protect significant loopholes for wealthy and well-advised debtors, raise the cost of the system for all parties, turn the government into a private collection agency for large creditors, and force women trying to collect child support or alimony to compete with credit card companies that will have more of their debts declared non-dischargeable.

The simple reality is that time and changes in the American economy have passed by the substance of this bill. Even if it was a flawless bill when it first was introduced eight years ago (and it was not), the events of the past eight years have dramatically changed the landscape in which we now consider it. The ability to file for bankruptcy and to receive a fresh start provides crucial aid to families overwhelmed by financial problems. This bill would seriously compromise the bankruptcy protections these families need.

This legislation is opposed by organizations and individuals most concerned with the bankruptcy system, the rights of consumers, the needs of single parents and children, the elderly, working families, and civil rights.

Among the organizations that have opposed, or have expressed serious concerns with S. 256 and its predecessors since the 105th Congress are:

(1) groups concerned with the rights of workers including: AFL-CIO, Air Line Pilots Association, American Federation of Labor and Congress of Industrial Organizations, American Federation of State, County and Municipal Employees (AFSCME), Transport Workers Union, Service Employees International Union, Union of Needletrade Industrial and Textile Employees (UNITE), United Food and Commercial Workers International Union, United Mine Workers of America, United Steelworkers of America, Communication Workers of America, International Association of Machinist and Aerospace Workers, International Brotherhood of Boilermakers, Iron Shipbuilders, Blacksmiths and Forgers, International Brotherhood of Electrical Workers, International Brotherhood of Police Officers, International Brotherhood of Teamsters, International Union UAW, Laborers International Union of North America, National Association of Government Employees, PACE International Union, and UNITEHERE;[12]

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[11] *See* TAMARA DRAUT & JAVIER SILVA, DEMOS: A NETWORK FOR IDEAS AND ACTION, BORROWING TO MAKE ENDS MEET: THE GROWTH OF CREDIT CARD DEBT IN THE 90S 13 (2003) *available at* www.demos-usa.org.

[12] Letter from Charles Loveless, Director of Legislation, American Federation of State, County, and Municipal Employees, to Members of Congress (Feb. 25, 2005); Letter from William Klinefelter, Legislative and Political

(2) groups of non-partisan bankruptcy lawyers, judges, academics, physicians and banks including: American Association of University Women, American Bar Association, American Federation of Teachers, Association of Enterprise Organizations, Community Development Venture Capital Association, Klee, Tuchin & Bogdanoff LLP, Latino Community Credit Union, National Bankruptcy Conference, National Community Capital Association, National Conference of Bankruptcy Judges, National Association of Chapter 13 Trustees, National Association of Bankruptcy Trustees, Commercial Law League of America, the American College of Bankruptcy, and National Association of Consumer Bankruptcy Attorneys, a group of 110 professors of bankruptcy and commercial law, and a group of 1,700 physicians from around the country wrote to Congress in opposition to S. 256 because it would remove protections available to patients ruined financially by medical expenses;[13]

(3) groups concerned with the rights of women, children, seniors, and victims of crimes and torts including: Alliance for Retired Americans, Business and Professional Women/USA, Children's Foundation, Church Women United, National Council of Jewish Women, National Council of Women's Organizations, National Organization for Women, National Women's Law Center, and OWL – The Voice of Midlife and Older Women;[14]

(4) groups concerned with consumer protection, civil rights, and social justice including: American Friends Service Committee, Association of Community Organization for Reform Now (ACORN), Center for Community Change, Commission on Social Action of Reform Judaism, Consumer Federation of America, Consumers Union, Leadership Conference on Civil Rights,

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Director, United Steelworkers of America, to Members of Congress (Feb. 28, 2005); Letter from Ala n Reuther, Legislative Director, UAW, to Members of Congress (Feb. 28, 2005); Letter from American Federation of Labor and Congress of Industrial Organizations, AFSCME, American Federation of Teachers, Communications Workers of America, International Association of Machinist and Aerospace Workers, International Brotherhood of Boilermakers, Iron Shipbuilders, Blacksmiths, and Forgers, International Brotherhood of Electrical Workers, International Brotherhood of Police Officers, International Brotherhood of Teamsters, UAW, Laborers International Union of North America, National Association of Government Employees, Air Line Pilots Association, PACE International Union, Service Employees International Union, United Food and Commercial Workers International Union, United Mine Workers of America, United Steelworkers of America, and UNITEHERE, to Members of Congress (Feb. 28, 2005); Letter from Patricia Campos, Legislative Director, UNITEHERE, to Members of Congress (Mar. 1, 2005).

[13] Letter from Bill Edwards, Executive Director, Association of Enterprise Organizations, Mark Pinsky, National Community Capital Association, John Herrera, Board Chair, Latino Community Credit Union, and Kerwin Tesdell, CEO, Community Development Venture Capital Association, to Members of Congress (Mar. 14, 2005); Letter from Robert Evans, Director, American Bar Association, to Honorable Arlen Specter, Chairman, Senate Judiciary Comm. (Feb. 8, 2005); Letter from David Himmelstein & 1,700 Doctors, to Members of Congress (Feb. 14, 2005); Letter from Richard Aaron & 109 professors, to Honorable Chairman James Sensenbrenner & Ranking Member John Conyers (Mar. 11, 2005); Letter from Ken Klee, Partner, Klee, Tuchin, Bogdanoff & Stern LLP, to Members of Congress (Mar. 10, 2005).

[14] Letter from Nancy Duff Campbell et al., Co-President, National Women's Law Center, to Honorable John Conyers, Ranking Member, House Judiciary Comm. (Mar. 14, 2005); Letter from Edward Coyle, Executive Director, Alliance for Retired Americans, to Members of Congress (Feb. 28, 2005); Letter from Lisalyn Jacobs, Vice President for Government Relations, National Organization of Women (NOW), to Members of Congress (Feb. 28, 2005).

Lutheran Office for Governmental Affairs ELCA, NAACP, National Advocacy Center of the Sisters of the Good Shepard, National Community Reinvestment Coalition, National Consumer Law Center, Neighborhood Assistance Corporation of America, Network – a National Catholic Social Justice Lobby, Public Justice Center, and U.S. Public Research Group.[15]

Many of these concerns have been expressed since the introduction of the precursor bills beginning with the 105th Congress.[16] The reported bill is virtually identical to the conference report on H.R. 333 in the 107th Congress with the exception of an important provision that would have prevented the discharge, or the abuse of the bankruptcy system to hinder, delay and defraud creditors, of debts arising from violations of the Freedom of Access to Clinic Entrances Act.[17] There is no reason for the deletion of this amendment that reflects a compromise among Sen. Charles Schumer, Sen. Orrin Hatch and Rep. Henry Hyde, other than the conclusion of the bill's sponsors that protecting women's constitutional rights would interfere with the passage of this special-interest legislation.

For all the foregoing reasons, and the reasons discussed below, we dissent from this legislation.

Section I describes concerns about the lack of empirical justification for this bill. Section II describes the consumer provisions, including, most notably, the means test. Section III discusses flaws in the small business and single-asset real estate provisions, Section IV turns to

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[15] Letter from Travis Plunkett, Legislative Director, Consumer Federation of America, to the Honorable Chairman James Sensenbrenner and Ranking Member John Conyers (Mar. 15, 2005); Letter from Susanna Montezemolo, Policy Analyst, Consumers Union, to Members of Congress (Mar. 1, 2005); Letter from Wade Henderson et al., Executive Director, Leadership Conference on Civil Rights, to Members of Congress (Mar. 14, 2005).

[16] A number of editorials and articles have been written in opposition this bill. Riva Atlas & Eric Dash, *Bracing for Bankruptcy Rush*, N.Y. TIMES, Mar. 11, 2005, at C1; *Bankruptcy Reform Hurts Struggling Families*, BALT. SUN, Mar. 4, 2005, at A15; David Broder, *A Bankrupt 'Reform,'* WASH. POST, Mar. 13, 2005, at B7; *Bum of a Bankruptcy Bill: The Legislation Would Add Unfairly to the Misfortune of Many*, AKRON BEACON-JOURNAL, Mar. 6, 2005, at B3; Jonathan Chait, *When Democrats Join the Dark Side; Their Kowtowing to Home-state Industries Props up the Republicans*, L.A. TIMES, Mar. 4, 2005, at B13; E.J. Dionne, *A Morally Bankrupt Bill Democrats Should rally Against A Bankruptcy Bill That Hurts the Most Vulnerable*, PITTSBURGH POST-GAZETTE, Mar. 1, 2005, at A15; Annette Dunlap, *Right Ignores Bible's Words about Debt Scripture, Calls for Protecting People from Enslavement to Creditors*, CHARLOTTE OBSERVER, Mar. 21, 2005, at A13; *For Banks a Triumph of Greed*, N.N.J. RECORD, Mar. 17, 2005, at L11; *How a Bad Bill Becomes Law*, S. F. CHRON., Mar. 13, 2005, at C4; Walter Kirn, Broke, N.Y. TIMES, Mar. 27, 2005, at F7; Stephen Labaton, *A New Mood in Congress to Forgo Corporate Scrutiny*, N.Y. TIMES, Mar. 9, 2005, at C3; *Morally Bankrupt*, THE NEW REPUBLIC, Mar. 2005; Shanon Murray, *The Bankruptcy Game Looms*, The Deal Dot Com, Mar. 11, 2005, *at* www.thedeal.com; Norman Pressman, *Bankruptcy Changes Will Enslave BusinessPeople*, ST. LOUIS POST-DISPATCH, Mar. 27, 2005; *Reshape Bankruptcy with More Fairness*, KANSAS CITY STAR, Mar. 29, 2005; Michelle Singletary, *Bankruptcy Bill Lingers in the Ring*, WASH. POST, Mar. 3, 2005, at E3; *The Flawed Bankruptcy Bill Legislation Would Harm People Forced into Insolvency by Life's Vagaries*, BUFF. NEWS, Mar. 9, 2005, at A6; Cynthia Tucker, *Bush Cheats Those He Owes*, ATLANTA JOURNAL-CONSTITUTION, Mar. 13, 2005, at F8; Elizabeth Warren, *Sick and Broke*, WASH. POST, Feb. 9, 2005, at A23; *Working Class Forsaken in Favor of Special Interests*, BUCKS COUNTY COURIER TIMES, Mar. 24, 2005, at A10.

[17] 18 U.S.C. § 248 (2004).

the tax sections of S. 256, and Section V looks at corruption in the bankruptcy system. The following is a table of contents summarizing this analysis:

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I. LACK OF EMPIRICAL JUSTIFICATION

One of the major reasons accounting for the differing views regarding S. 256 relates to differing understandings of the quantitative evidence of the causes, costs, and effects of bankruptcy. S. 256's proponents point to (1) the fact that the United States has experienced a dramatic growth in the number of personal bankruptcy filings in the last decade[18] and (2) credit industry-funded studies by Professor Michael Staten of Georgetown University's Credit Research Center,[19] Ernst & Young,[20] and the WEFA[21] group that purport to demonstrate that the bankruptcy laws allow many relatively high income individuals to avoid debts they could otherwise pay and that this avoidance imposes substantial costs on the economy. Proponents of S. 256 point to the "opportunistic personal filings" for bankruptcy and the declining stigma associated with doing so to explain the increase in filings.[22]

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[18] According to the Administrative Office of the United States Courts, total bankruptcies filed for calendar year 2004, declined by 3.8% compared with calendar year 2004. This represents a total of 1,597,462 for 2004, compared with 1,660, 245. Non-business filings, which comprise the largest portion of total bankruptcy filings declined 3.8% (from 1,625, 208 to 1,563,145). The number of business fillings fell 2.1% (from 35,037 to 34,317). By chapter: Ch. 7 filings declined 3.3% (from 1,176,905 to 1,137,958); ch. 13 filings declined by 5.1% (from 473,137 to 449,129); ch. 11 filings were the only ones to increase. They rose by 7.7% (from 9,404 to 10,132); chapter 12 filings dropped to 108 from 712 filings. Press Release, Administrative Office of the U.S. Courts, Bankruptcy Flings Drop in Calendar Year 2004 (March 1, 2005) (on file with author).

[19] Professor Michael E. Staten of Georgetown University's Credit Research Center ("CRC"), which has many credit industry officials on its board, conducted what is perhaps the most-discussed study. JOHN M. BARRON & MICHAEL E. STATEN, PURDUE UNIVERSITY CREDIT RESEARCH CENTER, PERSONAL BANKRUPTCY: A REPORT ON PETITIONERS' ABILITY TO PAY (Oct. 1997). Staten concluded that 5% of chapter 7 debtors could repay all of their non-priority, non-housing debt over 5 years, 10% could repay at least 78% of such debt, and 25% could repay 30% of their debt. *Id.* at 26. *See also Bankruptcy Reform Act of 1999: Hearing on H.R. 833 Before the House Comm. on the Judiciary*, 106th Cong. 520 (March 17, 1999) (statement of Michael E. Staten, Professor and Director, Credit Research Center, Georgetown University).

[20] An Ernst & Young study, funded by VISA USA and MasterCard International, purports to corroborate the CRC findings. POLICY ECONOMICS AND QUANTITATIVE ANALYSIS GROUP, ERNST & YOUNG LLP, 1997 BANKRUPTCY PETITION STUDY: EXPERIENCE APPLYING A TOTAL QUALITY DESIGN PARADIGM 1 (1998) *available at* http://www.amstat.org/sections/srms/Proceedings/papers/1998_019.pdf.

[21] Wharton Econometric Forecasting Associates ("WEFA") examined the financial cost of personal bankruptcy cases filed in 1997, which it defined as "the amount of credit dollars (outstanding loans) lost due to bankruptcy filings . . . [and] the costs of the U.S. court system . . . and other creditor's expenses relating to bankruptcy." WEFA GROUP RESOURCE PLANNING SERVICE, THE FINANCIAL COSTS OF PERSONAL BANKRUPTCY 4 (Feb. 1998). The WEFA study calculated that "financial losses due to 1997 personal bankruptcies totaled more than $44 billion . . . . Unsecured nonpriority losses totaled almost $35 billion in 1997 . . . [and] passing such financial losses on to consumers in terms of higher prices would cost the average household over $400 annually." *Id.* at 1. The WEFA study also concluded that the needs based proposal in H.R. 3150 "should decrease financial costs due to bankruptcy . . . from 8% to 17% annually." *Id.* at 2.

[22] *Hearing on H.R. 833, the Bankruptcy Reform Act of 1999, Before the House Subcomm. on Commercial and Admin. Law*, 106th Cong. (March 17, 1999) (written statement of Michael E. Staten); *Joint Hearing Before the House Subcomm. on Commercial and Admin. Law and the Senate Subcomm. on Admin. Oversight and the Courts*, 106th Cong. (March 11, 1999) (written statements of (1) Bruce L. Hammonds, Senior Vice Chairman of MBNA Corporation; (2) Judge Edith H. Jones, U.S. Court of Appeals for the Fifth Circuit; (3) Professor Todd J. Zywicki, George Mason University School of Law; and (4) Dean Sheaffer, National Retail Federation).

Despite the earlier trend in higher numbers of bankruptcy filings, the vast weight of studies have contradicted the proponents' rationales and have shown that the filing rate is a symptom of financial difficulties. Analysts with the Congressional Budget Office,[23] the General Accounting Office,[24] and the Federal Deposit Insurance Corporation all have called into question the conclusions of those studies. These critiques focus on a number of grounds, including numerous flaws in the analysis and the assumptions underlying the studies. Moreover, other analyses indicate that the rise in bankruptcies is more properly attributable to a number of changes unrelated to the bankruptcy laws, such as unexpected medical costs, family crises like divorce, loss of high-paying full-time jobs, and most notably, the deregulation of credit card interest rates and the dramatic increase in credit card solicitations and overall consumer debt.[25] Even a credit

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[23] Kim Kowalewski of the Congressional Budget Office ("CBO"), at the request of the National Bankruptcy Review Commission, conducted a review of three economic analyses of this question. Kowalewski concluded that a 1996 VISA study did not support such a conclusion and, in fact, "because the social trends variable is flat during 1995 and early 1996, VISA believes that their social factors played no role behind the increase in personal bankruptcies in that period." KIM J. KOWALEWSKI, EVALUATIONS OF THREE STUDIES SUBMITTED TO THE NATIONAL BANKRUPTCY REVIEW COMMISSION 4 (Oct.6, 1997). At the request of Subcommittee Democrats, Mr. Kowalewski reviewed the economic issues affecting the rate and nature of bankruptcy in the United States. The Democratic Members made their original request on January 14, 1998; the response from CBO, in draft form only, was delivered April 16, 1999, over one year later. Mr. Kowalewski has still not been made available to testify before the Committee.

[24] At the request of Senators Charles Grassley and Richard Durbin, the General Accounting Office ("GAO") examined the CRC study and found five areas of concern: (1) data supplied by the debtors regarding their income expenses, debts, and the stability of their income and expenses over a 5-year period were not validated, (2) the report did not define the universe of debts for which it estimated debtors' ability to pay, (3) payments on non-housing debts that debtors stated they intended to reaffirm were not included in debtor expenses in determining the net income debtors had, (4) the CRC did not account for the considerable variation among the 13 locations used in the analysis, and (5) a scientific random sampling methodology was not used to select the 13 bankruptcy locations or the bankruptcy petitions used in the analysis. GENERAL ACCOUNTING OFFICE, PERSONAL BANKRUPTCY: THE CREDIT RESEARCH CENTER REPORT ON DEBTORS' ABILITY TO PAY 2S3 (1998) *available at* http://www.gao.gov/archive/1998/gg98047.pdf. The GAO also was concerned with Ernst & Young's bankruptcy study because the study: did not validate the data reported on the debtor's schedules; assumed that the unvalidated data would be stable and consistent throughout the five-year repayment period; assumed that 100 percent of the debtor's net income was expected to go to debt repayment; and assumed that the debtor would satisfactorily complete the repayment plan. GENERAL ACCOUNTING OFFICE, PERSONAL BANKRUPTCY: THE CREDIT RESEARCH CENTER AND ERNST & YOUNG'S REPORTS ON DEBTORS' ABILITY TO PAY 9 (1998) *available at* http://www.gao.gov/archive/1998/gg98076t.pdf. The GAO also had concerns with WEFA's report because it did not contain sufficient information regarding the reasonableness of the assumptions and methodology that they used. GENERAL ACCOUNTING OFFICE, PERSONAL BANKRUPTCY: THE WEFA REPORT ON THE FINANCIAL COSTS OF BANKRUPTCY 15 (1998) *available at* http://161.203.16.4/paprpdf2/160330.pdf.

[25] The Federal Deposit Insurance Corporation ("FDIC") contested many of assertions made in the above-noted studies. BANK TRENDS (FDIC, Washington, D.C.) March, 1998 *available at* http://www.fdic.gov/bank/analytical/bank/bt_9805.html. The FDIC observed a strong correlation between credit card default rates and personal bankruptcies, both of which increased in the 1990's. *Id.* The FDIC found that, because of and following interest rate deregulation in 1978, credit card companies became more profitable and credit card lenders were able to extend more unsecured credit to less creditworthy borrowers. *Id. See also* Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249, 254 (1997) (stating that the rise in bankruptcies has strongly correlated with the rise in credit card debt delinquencies that consumers have incurred); David U. Himmelstein et al., *Marketwatch: Illness and Injury as Contributors to Bankruptcy*, W5 HEALTH AFF. 63, 66 (2005) (finding that almost half of all debtors filing for bankruptcy did so because of a "major medical bankruptcy") *at* www.healthaffairs.org.

card industry official found that "[t]he majority of bankruptcies in [its] file are on customers who have been on the books for more than three years and have had some significant change in their financial condition."[26] It also has been shown that the average income of persons filing for bankruptcy has declined from the 1980's, further contradicting assertions of widespread abuse by high-income individuals.[27]

One of the most telling studies was performed by the non-partisan American Bankruptcy Institute, which commissioned Professors Marianne B. Culhane and Michaela M. White of the Creighton University School of Law to conduct a study independent of the credit industry.[28] Professors Culhane and White used for their study a database of chapter 7 cases; the National Conference of Bankruptcy Judges funded the compilation of the database.[29] The study estimated that 3.6% of the debtors in their sample had sufficient income, after deducting allowable living expenses, to pay all of their non-housing secured debts, all of their unsecured priority debts, and at least 20% of their unsecured nonpriority debts.[30] Moreover, in making their calculations, Professors Culhane and White assumed that 100% of the debtors in chapter 13 would complete a five-year repayment plan even though more than 60% of voluntary chapter 13 plans currently do not complete.[31]

The American Bankruptcy Institute study also showed that, while the credit industry estimates it may be eligible recover $4 billion under the rigid standards of the means test, creditors

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[26] *Joint Hearing Before the House Subcomm. on Commercial and Admin. Law and the Senate Subcomm. on Admin. Oversight and the Courts*, 106th Cong. 81(March 11, 1999) (written statements of Bruce L. Hammonds, Senior Vice Chairman of MBNA Corporation).

[27] While bankruptcy rates have been on the rise as a result of the current recession both the American Bankruptcy Institute and Professor Ausubel pointed out, that the earlier rise in personal bankruptcy rates, which were used to manufacture fear of a so-called bankruptcy crisis, in fact ended in 1998. American Bankruptcy Institute, *ABI Testifies on Bankruptcy Reform Bill*, 18 ABI Journal 1 (Apr. 1999) *at* http://www.abiworld.org/Template.cfm?Section=199921&CONTENTID=8602&TEMPLATE=/ContentManagement/ContentDisplay.cfm; LAWRENCE M. AUSUBEL, UNIVERSITY COLLEGE LONDON, A SELF-CORRECTING "CRISIS": THE STATUS OF PERSONAL BANKRUPTCY IN 1999 1 (Mar. 10, 1999). In fact, the ABI found that "consumer bankruptcy filings have dropped dramatically nationwide in January and February [1999], after three consecutive years of record filings." AMERICAN BANKRUPTCY INSTITUTE, *supra*, at 1. Specifically, "[t]he personal bankruptcy filing rate per thousand population grew at an annual rate of only 1.5% in the last year, and at a (seasonally-adjusted) annual rate of only 1.0% in the last quarter." LAWRENCE M. AUSUBEL, *supra*, at 1. The crisis corrected itself because lenders, as they normally would, tightened their lending practices when defaults became more common and infringed upon profits, thereby limiting the number of people going into debt and filing for bankruptcy. *See id.* at 3. The decline in bankruptcy filings for the last calendar year bears this out. Administrative Office of the U.S. Courts, *supra* note 11.

[28] *Hearing on H.R. 833, the Bankruptcy Reform Act of 1999, Before the House Subcomm. on Commercial and Admin. Law*, 106th Cong. 526 (March 17, 1999) (statement of Marianne B. Culhane); Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AM. BANKR. INST. L. REV. 27, 30 (1999).

[29] Culhane & White, *supra* note 28, at 30.

[30] *Id.* at 32S34.

[31] *Id.* at 59S60.

would receive at best $450 million in actual collections.[32] These figures are significantly lower than those of the Credit Research Center and VISA – two studies funded by the credit industry – and show that the credit industry may have overstated the "problem" by as much as 500%.[33] The Executive Office of United States Trustees in the Justice Department conducted a study that reached similar results, estimating that passage of the legislation probably would have netted creditors no more than 3% of the $400 per household they claim to be losing.

Professor Staten, whose work for the credit industry provided much of the empirical fodder for this legislation, has observed that this legislation would only move about 5% of all chapter 7 cases into chapter 13, and that the legislation would have no effect on the number of bankruptcies.[34]

Similarly, according to James Blaine, CEO of the NC State Employees Credit Union, "Charge-offs, too, are well under control at .46% of total loans (less than 1%). In other words, 99.5% of credit union loans are repaid as promised. According to NCUA 41.1% of credit union charge-offs related to bankruptcy. Or said another way, just .19% (less than 2/10th of 1%!) of total credit union loans result in a bankruptcy loss. So taking a the high estimate of 15% rate of abuse, he calculates that total losses on loan portfolios are .0385% or less than 3/100ths of 1% (.19% x 15% = .0285% (less than 3/100ths of 1%)."[35]

Moreover, there is nothing in this bill to guarantee that any savings realized from this bill will be passed on to consumers. The bill does not require it and, quite frankly, although real interest rates continue to hover at record lows, very little of the benefit of these low rates have been passed on to credit card borrowers. Not surprisingly, there is no evidence that the credit card industry would pass on any of the "savings" from bankruptcy law changes to individual borrowers.[36] Instead the evidence shows that credit card companies, tend to maintain high interest

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[32] *Id*. at 29S31.

[33] *Id*.

[34] FDIC Roundtable On Consumer Debt (Statement of Michael Staten) (Feb. 28, 2003).

[35] James Blaine, *Only Thing Bankrupt Is Logic Behind 'Reform,'* CREDIT UNION J., Feb. 2003, at 23.

[36] In a recent interview with the Financial Times,

> James Sensenbrenner, chairman of the House Judiciary Committee, said the bill would help the financial services industry by encouraging consumers to borrow more sensibly. The legislation also carried an implicit responsibility for the industry, according to Mr Sensenbrenner, who will manage it in the House.
>
> "The responsible thing for credit-card issuers to do would be to reduce interest rates because there is less risk," he said. "If they don't, they will play into the hands of the opponents of the bill - it would reduce their credibility."

Andrew Balls et al., *Bankruptcy Bill Set for Passage After Eight Years*, FIN. TIMES, Mar. 2005, at 10.

rates, even when their own cost of credit declines.[37] In at least some cases, these patters appear to have been caused by unlawful behavior on the part of the credit card industry.[38]

An important study from Harvard University recently found that over fifty percent of all individuals who filed for bankruptcy did so as a result of some sort of medical emergency or situation in the family.[39] This study also found that many of the debtors had gone without some sort of privation in the preceding two years before the debtor filed for bankruptcy. Such privations included debtors going without: telephone service (40.3%), food (19.4%), doctor or dental visits (53.6%), and filling prescriptions(43%). This study provides further evidence that certain societal problems are causing people to have to file for bankruptcy.[40]

Recently, Demos: A Network for Ideas and Action, released a study contradicting the assumptions of this bill's proponents. The Demos study showed how the amount of credit card debt per person has risen in the last 10 years.[41] The study also showed how the increase in senior citizens filing for bankruptcy has been the greatest of any age group over the years.[42] Credit card debt among young Americans has increased dramatically in the 1990s.[43] The average young adult had over $4,000 in credit card debt in 2001. The average American family experienced a 53 percent increase in the amount of credit card debt that they owed.[44] The main reason that most Americans have been incurring much more credit card debt is not because of reckless consumption but because of the "growing gap household earnings and the costs of essential goods and services."[45] The Demos study also found that one of the reasons for the rising credit card debt

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[37] In 1996, Professor James Medoff, the Meyer Kestnbaum Professor of Labor and Industry at Harvard University, pointed out that, between 1980 and 1992, when the federal funds rate (the interest that banks charge for overnight loans) fell from 13.4% to 3.5%, a drop of nearly 10 percentage points, the average credit card interest rate rose from 17.3% to 17.8%. Professor Medoff suggests that during the 1980s, when interest rates were high, lenders learned a valuable lesson; consumer debtors in general pay very little attention to interest rates. *Hearing on H.R. 833, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 106th Cong. 221 (March 16, 1999) (written statement of the Honorable Joe Lee) (citations omitted).

[38] The Second Circuit Court of Appeals recently found that Visa and Mastercard's exclusivity rules that did not allow banks that issued their credit cards to issue credit cards of their competitors such as American Express were in violation of the Sherman Anti-Trust Act. The United States Supreme Court denied certiorari to the case. Visa v. United States, 125 S. Ct. 45 (2004).

[39] David U. Himmelstein et al., *Marketwatch: Illness and Injury as Contributors to Bankruptcy*, 24 HEALTH AFF. 63, 66 (2005) (stating that half of the surveyed debtors met at least one of the criteria for "major medical bankruptcy").

[40] *Id.* at 68.

[41] Press Release, Demos: A Network for Ideas and Action, Misguided Bankruptcy Bill Ignores the Financial Insecurity Forcing Families into Debt and Bankruptcy; Economic Consequences Would Be Severe (Feb. 24, 2005) (on file with author).

[42] HEATHER MCGAHEE & TAMARA DRAUT, DEMOS: A NETWORK FOR IDEAS AND ACTION, RETIRING IN THE RED: THE GROWTH OF DEBT AMONG OLDER AMERICANS 1 (2005).

[43] TAMARA DRAUT & JAVIER SILVA, DEMOS: A NETWORK FOR IDEAS AND ACTION, GENERATION BROKE: THE GROWTH OF DEBT AMONG YOUNG AMERICANS 1 (2005).

[44] TAMARA DRAUT & JAVIER SILVA, DEMOS: A NETWORK FOR IDEAS AND ACTION, BORROWING TO MAKE END'S MEET: THE GROWTH OF CREDIT CARD DEBT IN THE '90S 1 (2005).

[45] *Id.*

was due to the effective deregulation of the credit card industry and deceptive credit card industry practices such as excessive late fees and aggressive marketing in terms of solicitations.[46] Late fees were the largest jump in revenue for credit card companies increasing from $1.7 billion in 1996 to $7.3 billion in 2002.[47]

II. CONSUMER PROVISIONS

A. Current Law and Proposed Changes

Under current law, individuals facing financial difficulty may seek a variety of forms of relief under the bankruptcy laws, with chapter 7 (liquidation) being by far the most common form of relief sought. Under this chapter, debtors are required to forfeit all of their property other than their "exempt" assets (*i.e.*, assets deemed necessary for the debtor's maintenance, as determined under federal or state law, at the state's option) in exchange for receiving a discharge of their unsecured debts. Creditors are entitled to receive any net proceeds from the sale of the debtor's nonexempt property, subject to the statutory priority schedule.[48] The Bankruptcy Code does not permit the discharge of certain debts whose payments are considered to be important to society. Some of this debt is of the same nature as priority debt (*e.g.*, family support obligations and taxes), but the law also exempts from discharge debts incurred through the debtor's misconduct, such as debts arising from fraud and intentional injuries.[49]

While the decision to seek relief under chapter 7 or chapter 13 is voluntary at the discretion of the debtor, section 707(b) of the Bankruptcy Code grants the court the discretion to deny relief where the filing is found to be a "substantial abuse."[50] Under section 707(b), however, there is a presumption *in favor of* granting relief to the debtor. This stems in part from the costs and potential hardships associated with developing excessive barriers to chapter 7 eligibility, the belief that the "honest but unfortunate debtor" should be entitled to a "fresh start," the importance of encouraging risk-taking and entrepreneurship, and avoiding situations where it is impossible for individuals to escape aggressive creditor collection tactics.[51] Section 707(b) is not the only provision in the Bankruptcy Code that prevents individuals from misusing chapter 7. For example, creditors may request that certain debts be held nondischargeable under section 523(a), or that the debtor be denied a discharge altogether under section 727.

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46 *Id*. at 5.

47 *Id*.

48 11 U.S.C. § 507(a) (2004).

49 11 U.S.C. § 523(a) (2004).

50 The Code does not define the term "substantial abuse," which is used in § 707(b), although, some courts have found that the ability to pay an appreciable proportion of one's debts over three years, using future income, could constitute "substantial abuse." *See, e.g.*, Fonder v. United States, 974 F.2d 996 (8th Cir. 1992) (finding that the debtor could pay 89% of unsecured debts in three years); In re Krohn, 886 F.2d 123 (6th Cir. 1989) (stating that there was an ability to pay portion of debts from "ample income" in excess of $80,000 per year); In re Walton, 866 F.2d 981 (8th Cir. 1989) (explaining that the debtor had the ability to pay two thirds of debts in three years).

51 There are a number of disincentives to filing for bankruptcy, such as the fact that a chapter 7 bankruptcy will be disclosed on a debtor's credit report, and the law's prohibitions on repeat chapter 7 filings for six years.

A creditor may also seek dismissal of a debtor's petition for relief under chapter 7 under section 707(a), or seek to examine the debtor under Bankruptcy Rule 2004, which allows the creditor to examine an entity (including the debtor) as to acts, conduct, or property or to the liabilities and financial conditions of the debtor, or to any matter which may affect the administration of a debtor's estate, or to or to the debtor's right to a discharge." The creditors' lobby has asserted that it is the job of the government to expend funds to investigate a debtor, collect debts, and assert a creditor's rights under the Code notwithstanding the legal right of a creditor to assert those rights and powers under current law. In effect, it is the position of the proponents of this legislation that the government should assume the role of their debt collector *gratis*.[52]

A separate bankruptcy alternative available to individual debtors is chapter 13, which was formerly known as a wage earner's plan.[53] Under chapter 13, a debtor is permitted to retain his or her property, but is required to pay to creditors over a 3S5 year period out of future income at least as much as the creditors would have received under a chapter 7 liquidation, and is also required to pay all priority debts in full. To accomplish this, the debtor must propose a plan, administered by a trustee, that pays creditors in full or that devotes the debtor's "disposable income" after accounting for necessary support of the debtor, his or her family, or a business. In order to encourage the use of chapter 13 plans, which are currently voluntary, Congress determined that persons who meet their chapter 13 obligations are entitled to a broader discharge of their unpaid debts than is available under chapter 7. In addition, debtors are permitted to retain property whether or not the property is encumbered by liens and the debtor committed a prepetition default, so long as the chapter 13 plan cures any arrearages. In this manner, debtors can use chapter 13 to save their homes from foreclosure. In addition, in chapter 13 a debtor is permitted to bifurcate a loan on personal property, such as an automobile, into secured and unsecured portions based on its present value, and treat only the secured portion as a secured claim that must be paid in full with

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[52] Mr. **NADLER.** Sir, I understand. But are you aware that a creditor has the right under section 343 of the Code, in rule 2004 to conduct an extensive examination under penalty of perjury of the debtor's financial circumstances, including the production of documents?

Mr. **WALLACE.** Yes, I have done these things and they do take a fair amount of time and I bill my clients for them. They are expensive.

Mr. **NADLER.** So why should the Government obtain—why should the Government have to spend public money to do the job that the creditors should be doing?

Mr. **WALLACE.** Because it is a governmental program, sir. Because it is not the job of the creditor. It is the job of the Government. *Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, and the Need for Bankruptcy Reform Hearing before the House Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary* 108th Cong. (March 4, 2003) (Testimony of George Wallace, Esq., of Counsel, Eckert Seamans Cherin & Mellot, LLC, Washington, DC, on behalf of the Coalition for Responsible Bankruptcy Laws)

[53] The eligibility requirements for chapter 13 may be found in 11 U.S.C. § 109(e). To be eligible for chapter 13, an individual must have regular income and noncontingent, liquidated, unsecured debts of less than $307,675 and secured debts of less than $922,975. Individuals with debts in excess of the chapter 13 limits must reorganize under chapter 11.

interest.[54] Chapter 13 plans must provide for the payment of in full of all priority debts, such as taxes and family support obligations. A debtor also has the ability to cure defaults as part of her plan.[55]

S. 256 would institute a number of major changes to consumer bankruptcy, in general, and to chapter 7 and 13, in particular, that some have argued may reduce the number of bankruptcy filings (but will not reduce the number of cases of financial hardship), and that will undoubtedly serve as procedural and legal impediments to bankruptcy relief. These changes are purportedly designed to increase pay-outs to non-priority unsecured creditors, particularly credit card companies, as well as to certain secured lenders, especially those extending credit for automobile loans.

1. Means Testing

The most far-reaching change, set forth in section 102 of the bill, would institute a so-called "means testing" approach to consumer bankruptcy.[56] This new standard could create a presumption of abuse of the bankruptcy system and deny chapter 7 relief to debtors who fail a "means test."

The means test purportedly calculates the debtor's ability to repay her non-priority unsecured debts (such as credit card debts) over a five year period. If the debtor is found, using the means test formula, to be able to pay non-priority creditors as little as $100 per month for five years, the bill would create a presumption that the debtor is abusing chapter 7. In essence, the sole purpose of the means test is to advance the position of creditors who have made the riskiest debts, those that, as a matter of public policy, have been placed in line behind secured and priority creditors, such as single parents holding claims for child support.

Instead of using the debtor's actual or projected income to calculate the debtor's ability to repay, the bill uses a fictitious "current monthly income," which, with certain exclusions, is the average of the debtor's income for the six months preceding the filing of the case. Even if, as is frequently the case, the debtor's bankruptcy was triggered by the loss of a job, or other precipitous loss in income due to serious illness or mobilization for war, the means test would attribute to the debtor the lost income for the purposes of determining whether a debtor is abusing chapter 7.

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[54] This is known as a "stripdown." Specifically, except for certain home mortgages, a debtor in chapter 13 may be able to bifurcate a debt to a secured creditor, treating only the *current value* of the collateral as secured, even if it is less than the full amount of the loan, and treating the remaining debt as a non-priority unsecured debt.

[55] 11 U.S.C. § 1322(a)(2) (2004).

[56] Subsection (a) of section 102 amends section 707(b) of the Bankruptcy Code to permit a court, on its own motion, or on motion of the United States trustee, private trustee, bankruptcy administrator, or party in interest, to dismiss a chapter 7 case for abuse if it was filed by an individual debtor whose debts are primarily consumer debts.

Similarly, instead of using the debtor's actual expenses to determine the ability to repay non-priority unsecured debts, the bill relies on guidelines developed by the Internal Revenue Service to aid in the collection of tax debts.[57]

Moreover, where the IRS has specific local expense standards, those standards do not always provide adequately for normal expenses. Ironically, Congress itself has recognized the inadequacy of such collection standards. The Internal Revenue Service Restructuring and Reform Act of 1998 directs the IRS to "determine, on the basis of the facts and circumstances of each taxpayer, whether the use of the schedules . . . is appropriate" and to ensure that they not be used "to result in the taxpayer not having adequate means to provide for basic living expenses."[58] However, neither that law, nor S. 256, grants this safeguard in the bankruptcy context.

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[57] Then-Chairman Hyde attempted to remove the inflexible means test when the bill was considered in the 106th Congress:

> Mr. Chairman, my colleagues are making a virtue out of what is a vice, and that is the inflexibility of the IRS standards. The cost of food in Omaha, Nebraska or Boise, Idaho, is different than in downtown Manhattan. So what is realistic about an inflexible standard? Why not give some wiggle room so that humanity can play out?
>
> This could be a good bill. It is a great bill for the creditors, I can say. I have 75 enhancements here for the creditors. Why not throw a little small bone to the debtor? Do not talk about ``reasonably necessary'' as too vague. Are my colleagues aware, those who have said that, that there is 15 years of litigation and decisional authority interpreting that? Of course. "Reasonable'' is a word used in negligence law, in the exercise of reasonable care and caution. To hear some of my colleagues talk, I would think this was from outer space. That is nonsense.
>
> We have to allow for regional differences, for family differences. A reasonably necessary standard is ascertainable.
>
> I am as capitalist as anybody, I am as conservative as anybody, but it does not seem to me when there is a bill that is truly tilted towards the creditors, that giving a little flexibility for living standards for people who are bankrupt is a violation of one's credentials as a conservative. The median income that the gentleman from Pennsylvania (Mr. GEKAS) mentioned of $51,000 sounds like a lot of money, but that is for a family of four, a family of four. That may be a lot of money in Boise, Idaho. It may be very little in New York.
>
> Give some flexibility. The current law is what ought to obtain. My colleagues are trying to change it by putting the IRS standards in. It is the first time, and I dare say the last time, so much kind approbation will be showered on the IRS by this side of the aisle. I certainly do not join in that showering.
>
> So this litigation, there will be litigation on the IRS standards, there will be as much litigation as anyone wants.
>
> This could be a good bill. I support this bill, but for goodness sake give some humanity in the establishment of living standards while paying out Chapter 13.
>
> Lastly, let me pay my respects to the creditor lobby. They are awesome.
>
> 145 CONG. REC. H2724 (1999) (Statement of Rep. Hyde).

[58] Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3462 (1998).

Although the means test is only applicable above median income,[59] the contention that debtors with income below the median would not be affected by the means test is false.

The inflexible and fictitious calculations in the means test are justified by proponents who point to a provision that allows a debtor to alter the income or expense assumptions of the means test by allowing adjustments for "special circumstances that require additional expenses or adjustments of current monthly total income, for which there is no reasonable alternative." Under the revised 707(b), a debtor would have to provide extensive documentation to the court, not to establish the debtor's actual financial condition, but to rebut the presumption of abuse, which may be challenged by the trustee or any creditor.[60]

The bill also makes substantial changes to chapter 13 by substituting the IRS expense standards to calculate disposable income for debtors earning over the median income, rather than the existing standard that uses the debtor's actual expenses "reasonably necessary for the maintenance and support of the debtor or a dependant of the debtor.[61] Although the bill does allow certain specified adjustments to the IRS standards, the formula remains inflexible and divorced from the debtor's actual circumstances.

The means test is also used to calculate a debtor's income and expenses for the purposes of confirming a chapter 13 plan. Unlike the means test in chapter 7, however, there is no provision for a debtor to seek adjustments to current monthly income for "special circumstances," making the application of the means test in chapter 13 even more inflexible and divorced from reality. Unlike the means test in chapter 7, the means test in chapter 13 applies to all debtors, with no exceptions for those below the median income.

The bill also requires debtors to calculate the means test using expenses over 5 years rather than 3 years, and makes other changes to the way plans must be presented. These changes will guarantee that, if the means test pushes a debtor into chapter 13, the repayment capacity assumptions, and new mandates, would make it even less likely that a debtor would be able to complete a repayment plan in chapter 13 – the ostensible purpose of the means test in the first place. In view of the fact that approximately two thirds of all voluntary chapter 13 plans under current law are not completed, it is likely that even more debtors would be unable to confirm or

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[59] Two forms of "safe harbors" are recognized under section 102(a). One provides that only a judge, United States trustee, bankruptcy administrator, or private trustee may bring a motion under section 707(b) of the Bankruptcy Code if the chapter 7 debtor's income (or in a joint case, the income of debtor and the debtor's spouse) does not exceed the state median family income for a family of equal or lesser size (adjusted for larger sized families), or the state median family income for one earner in the case of a one-person household. The second safe harbor provides that no motion under section 707(b)(2) may be filed by a judge, United States trustee, bankruptcy administrator, private trustee, or other party in interest if the debtor and the debtor's spouse combined have income that does not exceed the highest median family income in the debtor's state for a family of equal or lesser size (adjusted for larger sized families), or the state median family income for one earner in the case of a one-person household. Certain disabled veterans are exempted from dismissal on the basis of the means test.

[60] *Id*. at § 102 (proposed amendment to 11 U.S.C. § 707).

[61] 11 U.S.C. § 1325(b) (2004).

complete the now-mandatory chapter13. This legislation also greatly curtails the broader discharge currently available to debtors who have successfully completed a chapter 13 plan, eliminating a significant inducement for voluntary debtor participation in chapter 13.[62]

2. Exceptions to Discharge & Loan Bifurcations

S. 256 would make significant additions to the types of debts that a debtor may not discharge under chapters 7 or 13, and greatly curtail a debtor's ability to bifurcate a loan into secured and unsecured portions based upon the value of the collateral.

Section 310 would create a presumption of non-dischargeability for credit card debts of $500 or more in the aggregate (as opposed to $1,225 under current law) or more owed to a single creditor for "luxury goods or services" incurred within 90 days prior to the bankruptcy filing (as opposed to 60 days under current law).[63] Additionally, section 310 also makes presumptively nondischargeable cash advances aggregating at least $750 incurred within 70 days before the order for relief, to one or more creditors in an open-ended credit plan. This means that, if a debtor uses several cards to purchase basic household needs (there is no requirement that these cash advances be used for luxury goods) over a 70 day period, even if the debt to each creditor is a fraction of the $750 threshold, all the debts would be presumed fraudulently incurred. Current law makes cash advances aggregating more than $1,250 nondischargeable if they are incurred within 90 days before the order for relief.[64] Section 314 adds another exception to discharge when the "debtor incurred the debt to pay a tax to a governmental unit that would be nondischargeable."[65] Therefore, regardless of the debtor's intent, any debts incurred to pay a nondischargeable tax debt would be nondischargeable.[66] This particular change will have a devastating impact on taxpayers who, at the urging of taxing authorities, pay their taxes electronically using a credit card.

The legislation would also largely eliminate the possibility of loan bifurcations in chapter 13 cases. Under current law a debtor is permitted to bifurcate a loan between the secured and unsecured portions. The debt is treated as a secured debt up to the allowed value of the property securing the debt. The remainder of the debt is treated as a non-priority unsecured debt. Section 306 of the legislation prevents such bifurcations (including with regard to interest and penalty provisions) with respect to any loan for the purchase of a vehicle in the 910 days before bankruptcy, as well as all loans secured by other property incurred within one year before bankruptcy.

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[62] *Id*. at § 314(b) (proposed amendment to 11 U.S.C. § 1328(a)).
[63] *Id*. at § 310 (proposed amendment to 11 U.S.C. § 523(a)(2)(C)).
[64] 11 U.S.C. 523(a)(2)(C).
[65] S. 256, § 314 (proposed amendment to 11 U.S.C. § 523(a)).
[66] *Id*. at § 315.

3. Domestic Support

Sections 211S219 of the bill make a number of changes to current law that are purportedly intended to enhance the status of child support and alimony payments in bankruptcy. These changes are presumably being made in an effort to offset the considerable criticism the legislation has received from children and family advocates.

Section 211 creates a new definition of "domestic support obligation."[67] In addition to applying to debts owed on account of child support and alimony, which are already nondischargeable under current law,[68] the new definition includes alimony and child support debts owed or recoverable to a governmental unit.[69] This definition is in turn relevant to new sections of the Bankruptcy Code that give certain enhanced rights to the holders of domestic support obligations in terms of priorities, payments, automatic stay, preferences, and foreclosure placing the rights of children and custodial parents in conflict with the claims of governmental entities.[70]

Section 212 grants alimony and child care creditors a first priority in bankruptcy (they are currently seventh, although most of the higher priority debts are seen rarely in consumer bankruptcy cases).[71] Section 213 prevents the confirmation of a reorganization plan unless the debtor has paid all domestic support obligations.[72] Section 214 provides that the automatic stay does not prevent legal actions enforcing wage orders for domestic support obligations and similar actions.[73] Section 215 makes nondischargeable all domestic support obligations, including obligations owed to government support agencies. Section 216 permits nondischargeable domestic support obligations to be collected from property – notwithstanding state laws making that property exempt from collection or attachment – after bankruptcy.[74] Section 217 makes clear that a transfer that was a bona fide payment for a domestic support obligation will not be considered a fraudulent or preferential prepetition transfer.[75] Section 218 specifies that alimony and child support payments are not included in the definition of disposable income in chapter 12 cases. Finally, section 219 of the bill requires trustees to send written notice to recipients of alimony and child support payments, and to the local and state child support agencies, notifying them that a debtor of such payments has filed for bankruptcy.[76]

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[67] S. 256, § 211 (proposed amendment to 11 U.S.C. § 101).

[68] 11 U.S.C. § 523(a)(6).

[69] *Id*.

[70] *See* S. 256, § 211 *et seq.*

[71] *Id*. at § 212 (proposed amendment to 11 U.S.C. § 507(a)). In the current enumeration of priorities, for example, the unsecured claims of a fishermen against the debtor have fifth priority. 11 U.S.C. § 507(a)(5).

[72] *Id*. at § 213.

[73] *Id*. at § 214 (proposed amendment to 11 U.S.C. § 362(b)). This includes the interception of tax refunds, the enforcement of medical obligations, or actions to withhold, suspend, or restrict licenses of the debtor for delinquency in support obligations.

[74] *Id*. at § 216 (proposed amendment to 11 U.S.C. § 522).

[75] *Id*. at § 217 (proposed amendment to 11 U.S.C. § 547(c)(7)).

[76] Notices to domestic support recipients must also state that they can use the services of a government support enforcement agency to collect the support.

4. Other Anti-Debtor Provisions

The legislation makes a host of additional changes to the consumer provisions of the bankruptcy laws. The majority of the provisions are designed to increase creditor pay outs and would greatly harm low- and middle-class debtors. As Harvard Law Professor Elizabeth Warren testified, the bill "has 217 sections that run for 239 pages" and "virtually every consumer provision aims in the same direction. The bill increases the cost of bankruptcy protection for every family, regardless of income or the cause of financial crisis, and it decreases the protection of bankruptcy for every family, regardless of income or the cause of financial crisis." [77] In 1999, then-Chairman Hyde himself noted that the bill contained at least 75 provisions detrimental to debtors and favorable to creditors. Among other things, the bill extends the period permitted between ch. 7 filings from the 6 years under current law to 8 years;[78] expands the ability of residential landlords to evict tenants without seeking permission from the court;[79] and significantly narrows the definition of household goods exempt from repossession in bankruptcy.[80]

B. Principal Problems with Proposed Changes

1. S. 256's Means Testing is Arbitrary and Unworkable in Practice

The National Bankruptcy Review Commission's majority specifically rejected the so-called "means testing" approach,[81] observing:

> The credit industry has sought means testing consistently for at least 30 years, but Congress has consistently refused to change the basic structure of the consumer bankruptcy laws. . . . . Access to chapter 7 and to chapter 13, the central feature of the consumer bankruptcy system for nearly 60 years, should be preserved.[82]

The 1973 Commission on Bankruptcy Laws similarly considered and rejected industry calls for mandatory chapter 13's, noting that Congress had itself rejected similar proposals in 1967, and observed:

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[77] *Bankruptcy Reform: Hearing on S. 256 Before the Senate Comm. on the Judiciary*, 109th Cong. (Feb. 10, 2005) (statement of Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School).

[78] S. 256, §312, *cf.* Duet. 15:1 - 2 – "Every seventh year you shall grant a remission of debts. And this is the manner of the remission: every creditor shall remit the claim that is held against a neighbor, not exacting it of a neighbor who is a member of the community because the Lord's remission has been proclaimed."

[79] S.256§311.

[80] S.256 §313.

[81] Only two members of the National Bankruptcy Review Commission signed onto a dissenting statement supporting the consideration of various means testing options. NATIONAL BANKRUPTCY REVIEW COMMISSION, FINAL REPORT: BANKRUPTCY - THE NEXT TWENTY YEARS 1131 (1997) (Additional Dissent to Recommendations for Reform of Consumer Bankruptcy Law Submitted by the Honorable Edith H. Jones and Commissioner James I. Shepard).

[82] *Id.* at 90S91.

> [B]usiness debtors are not subject to any limitation on the availability of straight bankruptcy relief, including discharge from debts, and it was pointed out that, quite apart from bankruptcy, business debtors are able to incorporate and to limit their liability to their investments in corporate assets. To force unwilling wage earners to devote their future earnings to payment of past debts smacked to some of debt peonage, particularly when business debtors could not be subjected to the same kind of regimen under the Bankruptcy Act. . . . The Commission concluded that forced participation by a debtor in a plan requiring contributions out of future income has so little prospect for success that it should not be adopted as a feature of the bankruptcy system.[83]

The principal problem with the means test is that the rigid one-size-fits-all test used in determining eligibility for chapter 7 and the operation of chapter 13 will often operate in an arbitrary fashion. Many of these flaws were highlighted in 1999 by then-House Judiciary Committee Chairman Henry Hyde when he unsuccessfully sought to delete the use of the rigid IRS standards and instead substitute a more fact-specific test based on the court's assessment of the debtor's actual reasonable and necessary expenses.[84]

Rather than relying on the debtor's actual costs of living, the bill relies upon IRS collection standards, which lay out no comprehensive or specific standards for the deduction of living expenses. Part of the problem arises from the fact that the IRS standards referenced by the bill are not automatic in many cases. Although the IRS does set forth national standards for some expenses, such as food and clothing,[85] and local standards for expenses such as housing and transportation,[86] it leaves the determination of "other necessary expenses" to the discretion of the relevant IRS employee.[87]

The seemingly arbitrary allowances for such expenses points to another problem with the means test under S. 256 – its bias against debtors without secured debts. The bill allows all secured debt payments to be deducted from monthly income, but limits rental and lease payments to the amount permitted by the IRS standards. This means that persons renting apartments and leasing cars may not be able to deduct the full amount of their housing and transportation costs in bankruptcy, while persons with mortgages and automobile debt will be able to do so.[88] There is

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[83] *Report of the Commission on Bankruptcy Laws*, H.R. Doc. No. 137, Part I, 93rd Cong. 158S59 (1973) (citation omitted).

[84] In 1999, the Committee had initially approved an amendment offered by Chairman Hyde eliminating the IRS collection standards from the means test. Subsequently, however, Rep. Graham (R-SC) offered an amendment reintroducing the IRS collection into the means test; effectively reversing the Chairman's earlier amendment. The Committee accepted this amendment by a vote of 17 - 14, largely on party lines, with Chairman Hyde and Rep Baccus (R-AL) crossing party lines to join with most Democrats in opposing the reinsertion of the IRS standards.

[85] IRS Manual § 5323.432.

[86] IRS Manual § 5323.433.

[87] IRS Manual § 5323.12.

[88] Higher income debtors can also easily plan around the means test by, for example, purchasing a new expensive car shortly before bankruptcy, or deferring tax and child support payments, thereby increasing priority claims.

no legitimate policy rationale for this discrepancy, which appears to punish people who rent and lease and nonetheless must resort to bankruptcy.

Also, it is important to note that the IRS collection standards can change the manner in which the bankruptcy laws are applied. The collection standards serve as internal guidelines for the IRS; they are not regulations that are subject to the Administrative Procedures Act. As such, the IRS does not need to provide notice, or seek public comment, when introducing new standards or when changing the existing ones. If the bankruptcy law was amended to incorporate the collection standards, as S. 256 proposes, and the IRS were to change the collection standards in the future, the alteration in the standards would completely change how the Bankruptcy Code is applied. In effect, S. 256 would delegate authority to the IRS to amend the Bankruptcy Code without notice.

It is no answer to assert, as the legislation's proponents have done, that the "glitches" in the collection standards can be resolved through the bill's allowance that "the presumption of abuse may only be rebutted by demonstrating special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative."[89] This is a new standard with no clear definition. It is unclear how the courts will apply it. Establishing "special circumstances" will be costly and burdensome.[90] It is the debtor's burden to show special circumstances. The debtor must present detailed documentation for expenses for adjustments to income and a detailed explanation of the special circumstances that make such expenses or adjustment to income the only reasonable alternative for the debtor. These requirements make it very difficult for debtors to claim special circumstances, since many expenses are paid in cash and cannot be documented. This risk provides a tremendous disincentive for debtors to claim special circumstances, let alone incur the legal costs the debtor himself is required to pay to defend against a creditor's motion.

Penalties available against creditors who file abusive motions under section 707(b) appear to provide the authority for the court to impose only attorney's fees and costs, not the civil penalties available against debtors' counsel. No penalties or fees could be imposed under the revised 707(b) for motions brought by "small businesses" with small claims, even if the court finds that Bankruptcy Rule 9011 had been violated.[91]

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[89] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. § 102 (2005) (proposed amendment to 11 U.S.C. 707(b)(2)(B)(I)). The final wording was formulated by staff in the 106th Congress using nothing more than a paperback thesaurus.

[90] *Id*. at § 102 (proposed amendment to 11 U.S.C. § 707(b)(2)(B)).

[91] Bankruptcy Rule 9011(b) provides, in part, "By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances ... it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the costs of litigation."

Under the bill, should a court grant a section 707(b) motion made by a trustee and find that the action of debtor's counsel in filing the chapter 7 case violated Federal Rules of Bankruptcy Procedure 9011, section 102(a) mandates that the court order the attorney to reimburse the trustee for all reasonable costs in prosecuting the motion, "Small business" is a deceptive term as used in this section. For the purposes of sparing a creditor sanctions under this section, a small business is a unincorporated business, partnership, corporation, association or organization that has fewer than 25 full-time employees (including wholly owned subsidiaries) and is engaged in commercial or business activity. A firm engaged whose sole business involves purchasing debts and attempting to collect on them in a in bankruptcy cases would qualify under this definition of a "small business," and would not be subject even to the lesser penalties imposed on creditors even if they violated BR 9011. Conversely, debtors' counsel are subject to both costs and civil penalties, and must certify that the client's statement about her financial circumstances are true.

There are also several serious interpretive problems caused by the drafting of the means test, which combines debt payment amounts with IRS allowances. For example, it the language of the bill needs to make clear that a debtor who has two payments remaining on a secured car loan is allowed the IRS car ownership allowance for the remaining 58 months. If not, the debtor may have no funds to replace a car that is already seven or eight years old at the outset of the five-year period and is essential for a long commute to work during the five-year term of the plan.

Finally, making chapter 13 the only avenue for bankruptcy relief for some individuals and imposing the bill's strict income and expense tests will undoubtedly result in an even smaller proportion of successful chapter 13 plans. It is also somewhat unrealistic to expect many chapter 13 cases to result in successful completion of repayment plans. The current chapter 13 completion rate is less than one-third,[92] for chapter 13 plans which are voluntary and with disposable income tests are less rigid than that proposed in this bill. Moreover, changes to chapter 13, such as the curtailment of stripdown, will make it more difficult for even debtors who file for chapter 13 voluntarily to confirm or complete a plan.

2. Means Testing Will be Costly and Bureaucratic

The bill's attempt to impose rigid financial criteria on debtors' eligibility for chapter 7 and the operation of chapter 13 will impose substantial new costs on the bankruptcy system – both the portions paid for by private parties (through payment for private chapter 7 and chapter 13 trustees and higher attorneys' fees) and the federal government (through the bankruptcy courts and the U.S. Trustees Program).

Testifying about the costs to private trustees, the National Association of Bankruptcy Trustees has complained:

> [U]nder the bill, trustees must (1) review the debtor's income and expenses prior to five days before the section 341 hearing, (2) file a 'certification' that the debtor

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including reasonable attorneys' fees. In addition, the court must assess an appropriate civil penalty, payable to the private trustee, bankruptcy administrator, or the United States trustee. FED. R. BANKR. P. 9011(B).

[92] NATIONAL BANKRUPTCY REVIEW COMMISSION, FINAL REPORT: BANKRUPTCY - THE NEXT TWENTY YEARS 90-91 (1997).

> is qualified to be a chapter 7 debtor at least five days before the section 341 hearing, (3) filed motions to dismiss under section 707(b) where the debtor's disposable income would yield [specified payments] to a chapter 13 trustee over a five-year plan. This is a great deal of work for trustees who only receive $60 in the typical chapter 7 case. In addition, the plight of the trustee is multiplied when, even if he is successful, he cannot count on any compensation.[93]

The most recent CBO estimate of the bill's cost to the federal government is $392 million over the next five years.[94] An additional cost of $26 million is estimated for additional judges necessary to administer the new rules. The total net increase in discretionary spending would be $146 million over the next five years since the bill would treat approximately $246 million in fees as an offset to the $392 million that it will cost the federal government. The two intergovernmental mandates would cost a combined $62 million but the unfunded mandate on private entities would exceed the Unfunded Mandates Reform Act (UMRA)[95] threshold at $123 million.[96] CBO's cost estimate for additional bankruptcy judges does not include the additional judges that the Judicial Conference estimates will be needed to apply current law, much less the additional need for judges to implement the costly and cumbersome changes in the bill. This request is based on current needs, not on actual needs if the bill passes. Hence the estimate of costs to the judiciary must be considered unrealistically low. Part of this cost-estimate derives from implementing the complex and paperwork-heavy means-testing program. CBO estimates it will cost some $150 million over the next five years.[97] However, this estimate may well be far too low. For example, Henry E. Hildebrand, Chair of the Legislative Committee of the National Association of Chapter Thirteen Trustees estimated that:

> Assuming that one out of nine cases filing for chapter 7 relief would be contested and further assuming that the contest would require about two hours of pretrial preparation and one hour of court time, the litigation would require 276,000 additional hours, about 90,000 of which would occupy the court.[98]

Another source of higher costs for the government is the requirement that one in every 250 cases in each federal district be randomly audited by independent certified public accountants or independent-licensed public accountants, at taxpayer expense under generally-accepted auditing standards. CBO estimated it will cost the federal government $66 million over five years to

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[93] *March 17, 1999 House Judiciary Committee Hearing on H.R. 833, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 106th Cong. 433 (March 17, 1999) (written statement of Robert H. Waldschmidt, National Association of Bankruptcy Trustees at 3).

[94] CONGRESSIONAL BUDGET OFFICE, COST ESTIMATE: S. 256 BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005 AS REPORTED BY THE SENATE COMMITTEE ON THE JUDICIARY ON FEBRUARY 17, 2005, at 1 (February 28, 2005) [hereinafter CBO 2005].

[95] Unfunded Mandates Reform Act of 1995, Pub. L. 104-4; 109 Stat. 50 - 60.

[96] *Id.*

[97] *Id.* at 5.

[98] Henry E. Hildebrand, *The Hidden Costs of Bankruptcy Reform* 2 (1998) (unpublished manuscript on file with the Committee on the Judiciary, minority staff).

effectuate this requirement.[99] It is unclear whether such costs will yield any comparable benefits. For example, the Honorable William Houston Brown, a U.S. Bankruptcy Judge in the Western District of Tennessee, testified on behalf of the ABI that the audits required "are likely to be very expensive, and such formal audits are likely unnecessary to determine significant misstatements in debtors' petitions and schedules."[100]

Other costs to the government under the bill include, the costs of the U.S. Trustee certifying the availability of credit counseling ($17 million over 5 years) and requiring the U.S. Trustee to visit sites in chapter 11 cases ($12 million over 5 years).

Another concern is the many, many new opportunities for litigation and confusion created by the bill. Judge Randall Newsome testified on behalf of the National Conference of Bankruptcy Judges that at least 16 potential sources of litigation are contained in the means testing provisions alone, and that another 42 litigation points have been identified in the other consumer provisions, noting that "[t]his is probably only the tip of the iceberg."[101]

Costs imposed on the private sector will also be substantial. The CBO said: "S. 256 would impose private-sector mandates, as defined in UMRA [the Unfunded Mandates Reform Act] on bankruptcy attorneys, creditors, bankruptcy petition preparers, debt-relief agencies and credit and charge-card companies. CBO estimates that the direct costs of these mandates would exceed the annual threshold established by UMRA ($123 million in 2005, adjusted annually for inflation)."[102]

Many of the costs and burdens on the private sector are illustrated in the American Bar Association's (ABA) recent letter concerning S. 256[103]. In particular, the ABA expressed its concern regarding provisions in the bill that would require attorneys to: (1) certify the accuracy of factual allegations in the debtor's bankruptcy petition and schedules, under penalty of harsh court sanctions; (2) certify the ability of the debtor to make payments under a reaffirmation agreement; and (3) identify themselves as "debt relief agencies" subject to a host of new intrusive regulations.

As the ABA has explained,

> The three general types of enhanced attorney liability provisions outlined above, when taken together, will have a substantial negative impact on the availability of quality legal counsel in bankruptcy. As a result of these

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[99] CBO 2005, at 8.

[100] *March 17, 1999 House Judiciary Committee Hearing on H.R. 833, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 106th Cong. 68 (March 17, 1999) (written statement of the Honorable William Houston Brown).

[101] *March 17, 1999 House Judiciary Committee Hearing on H.R. 833, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 106th Cong. 407 (March 17, 1999) (written statement of the Honorable Randall J. Newsome, President, National Conference of Bankruptcy Judges at 1).

[102] CBO 2005, at 1.

[103] Letter from Robert D. Evans, Director of Governmental Affairs, American Bar Association, to Hon. Arlen Specter, Chairman, Senate Committee on the Judiciary (Feb. 8, 2005).

> burdensome and one-sided mandates on debtors' attorneys, many attorneys who currently represent both debtors and creditors will stop handling debtor cases altogether rather than comply with these new regulations. With fewer attorneys available to represent debtors, many more debtors will be forced to file their bankruptcies *pro se*, without first obtaining adequate advice regarding the necessity or advisability of filing for bankruptcy. Therefore, the enhanced attorney liability provisions ultimately will have an adverse effect on debtors, creditors, and the bankruptcy system as a whole.[104]

3. Means Testing and the Other Consumer Provisions Will Harm Low- and Middle-Income People

a. Concerns Regarding the Means Test

It is incorrect to assume that the effect of S. 256's harmful provisions would be limited to individuals seeking bankruptcy relief who earn more than the state median income.

The definition of "current monthly income" used in the means test measures a debtor's income based upon how much the debtor earned in the six months prior to bankruptcy. If the debtor lost a good job in month three and has been working at a low-wage job ever since, the income from that good job, and help from family members, would be counted as if that is what his future income would be. The debtor would be expected to pay out of income that may no longer exist. Also, the means test will pick up a variety of revenue sources – such as disaster assistance, and Veterans' benefits – which will result in lower- and middle-income individuals being cast as bankruptcy "abusers" with income above the median.

In addition, due to the fact that S. 256, unlike current law, will permit creditors and other parties-in-interest to bring motions to dismiss or convert, more aggressive and well-funded creditors will have extremely wide latitude to use such motions as a tool for making bankruptcy an expensive, protracted, and contentious process for honest debtors, their families, and other creditors. Creditors could use such motions as leverage to obtain reaffirmation agreements so that their unsecured debts survive bankruptcy. The inability to obtain bankruptcy relief will force

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[104] *Id.*

more families out of the above ground economy and into a permanent state of unmanageable indebtedness.[105]

b. Other Concerns

The bill makes nondischargeable a wider range of debts including cash advances, and debts incurred for so-called luxury goods, and debts incurred to pay nondischargeable tax debts.[106] These new exceptions from discharge obviate many of the benefits that debtors may realize from filing for bankruptcy, under chapter 7 or 13 and increase the opportunity for creditor abuse. The provisions were opposed by then-President Clinton. In a communication to the Congress, that administration wrote that it is "generally inappropriate to make post-bankruptcy credit card debt a new category of nondischargeable debt . . . . We remain skeptical that the current protections against fraud and debt run-up prior to bankruptcy are ineffective and that the additional debts made nondischargeable by [S. 256] meet the standard of an overriding public purpose."[107]

Consumer bankruptcy expert Henry Sommer also has explained that such provisions:

> increase the opportunity for creditors to file the types of abusive fraud complaints which have been found by many courts to be baseless and unjustified attempts to coerce reaffirmations by debtors who cannot afford to defend them. The new presumptions of nondischargeability will fall mainly on low income debtors who are unsophisticated, do not have the time, budget flexibility, or attorney advice to plan their bankruptcy cases carefully, have to file on short notice to prevent utility shutoffs or other impending creditor actions and will not have the funds to defend dischargeability complaints."[108]

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[105] A study by the University of Maryland Department of Economics, illuminates the phenomenon of "informal bankruptcy", whereby debtors, especially those who are difficult to find or those with few attachable assets, may choose simply to stop making payments altogether and enter the underground economy. Amanda E. Dawsey &and Lawrence M. Ausubel, Informal Bankruptcy 1, U. MD. Dept. Econ., (Feb. 2002), at 2 (unpublished manuscript, *available at* http://www.ausubel.com/creditcard-papers/informal-bankruptcy.pdf). This then puts the burden on the creditors to collect. While informal bankruptcy lacks the legal protections afforded by (formal) bankruptcy, the incentives of informal bankruptcy cannot be underestimated, not the least of which is the lack of any administrative or legal costs initially. *Id*. at 2. Importantly, little consideration has been given to informal bankruptcy with respect to legislation, yet in 1996 some 66.7% of credit card loans were charged off for reasons other than bankruptcy. Id. at 1 (citing Visa U.S.A., 19997 Annual Bankruptcy Survey, Visa U.S.A. Inc., (September 2000)) .

[106] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. §§ 310, 314 (2005) (proposed amendment to 11 U.S.C. § 523(a)(2)(C)), and sec. 314.

[107] Letter from Jacob J. Lew, Director, Office of Management and Budget, to the Honorable Jerrold Nadler, Ranking Member, House Subcomm. on Commercial and Admin. Law 2 (Mar. 23, 1999) (on file with Minority staff of House Judiciary Comm.).

[108] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law,* 105th Cong., 2d Sess. 249 (Mar. 10, 1998) (written statement of Henry J. Sommer).

The new ban on loan bifurcations for car loans less than 910 days old will further erode the possibility of obtaining a fresh start through bankruptcy.[109] Automobiles depreciate rapidly once they leave the showroom. Before the loan is repaid, the value of the vehicle is often less than the unpaid balance of the loan. By prohibiting bifurcation, a lender with a secured loan that is underwater would be unjustly enriched by being able to treat the unsecured portion of that loan as fully secured to the detriment of other unsecured creditors. Such a prohibition on loan bifurcation is likely to render many chapter 13 plans unfeasible because a debtor may be able to repay the entire secured value, but not the entire purchase price of the car along with penalties. The provision also permits the lender to come out of the bankruptcy in a superior position than if it had foreclosed on the loan under applicable non-bankruptcy law.

Several other consumer provisions also will impose significant hardships on all debtors, regardless of income level or degree of culpability. For example, by allowing landlords to continue eviction or unlawful detainer actions even after debtors have obtained an automatic stay, the bill will force many battered women and families with children and seniors out onto the streets, without ever having an opportunity to use bankruptcy to catch up on their rent.[110]

Extending the permitted period between bankruptcy discharges to eight years[111] could prove a substantial hardship to families in already unstable economic situations.[112] The bill's narrow definition of exempt household goods could allow creditors to threaten foreclosure on household tools and children's sporting equipment, in order to obtain preferential treatment for itself.[113] This provision would work to the benefit of predatory and subprime lenders that take a security in interest in the borrower's personal effects.

4. The Consumer Provisions Will Have a Significant, Adverse Impact on Women, Children, Minorities, Seniors, Victims of Crimes and Severe Torts, Victims of Identity Theft, and the Military

a. Women and Children

S. 256 will have an adverse impact upon single mothers and their children, both as debtors and as creditors. On the debtor side, the means test, and all the additional paperwork burdens, will make it far more difficult for women to access the bankruptcy system. For example, women whose average income was at the median during the last 180 days, before the support checks stopped, may be denied access to chapter 7 and forced into restrictive chapter 13 repayment plans. Second, the bill does not exempt child support or foster care payments from the means test

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[109] S. 256, § 306.
[110] *Id.* at S. 256, § 311.
[111] *Id.* at S. 256, § 312 (proposed amendments to 11 U.S.C. §§ 727(a)(8), 1328).
[112] *Cf. Deuteronomy* 15:1-2 ("Every seventh year you shall grant a remission of debts. And this is the manner of the remission: every creditor shall remit the claim that is held against a neighbor, not exacting it of a neighbor who is a member of the community because the Lord's remission has been proclaimed").
[113] *Id.* at S. 256, § 313.

definition of disposable income.[114] By eliminating stripdown, the bill will also make it more difficult for women to hold onto the car they need to get to work, or the refrigerator or washing machine they need to care for their families if a creditor claims a security interest in such items.[115] The new nondischargeability categories also are problematic. It will be more difficult for custodial parents to discharge basic credit card debts. Even if a custodial parent filing for bankruptcy obtained cash advances to purchase basic necessities such as diapers or food, she could face litigation brought by a credit card company objecting to the discharge of the debt.[116]

The bill will have a particularly adverse impact on the payment of domestic support to women and children as holders of claims for alimony and child support. These concerns are by no means insignificant given that an estimated 243,000-325,000 bankruptcy cases involved child support and alimony orders during the most recent years.[117]

Under current law, alimony and child support are treated as priority debt and are not subject to discharge.[118] This preferential treatment dates from as early as 1903 and is based on Congress's determination that the payment of these debts is so important to society that it should come ahead of most general creditors. Although S. 256 does not revoke this special treatment, viewed as a whole, the legislation will have the effect of diminishing the likelihood of full payment of alimony and child support. This arises as a result of several features of the bill: its creation of significant new categories of nondischargeable debt, the extension of the length and onerousness of chapter 13 plans, and the bill's general limitations on the availability of chapter 7 relief.

Each one of these changes will make it less likely that a former spouse will be able to make his required alimony and child support payments. First, by making significant amounts of credit card debt nondischargeable, more of these debts will survive bankruptcy. Since most chapter 7 and 13 debtors do not have the ability to repay most of their unsecured debts, financial pressure on the debtor will continue after bankruptcy, decreasing his ability to handle important support obligations.

Collectively considered, these changes will help foster an environment where unsecured and credit card debt is far more likely to compete against alimony and child support obligations in the state law collection process. As a Congressional Research Service Memorandum analyzing an

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[114] *Id.* at S. 256, § 102.
[115] *Id.* at S. 256, §§ 310, 314.
[116] *Id.* at S. 256, § 310.
[117] Teresa Sullivan et al., *Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-91*, 68 AM. BANKRUPTCY L.J. 121, ## (1994). The reported data are from the Consumer Bankruptcy Project, Phase II. Principal researchers are Dr. Teresa Sullivan, Vice-President of the University of Texas; Jay Westbrook, Benno Schmidt, Chair in Business Law, University of Texas; and Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School. These estimates are based on data collected in 1991 in 16 judicial districts around the country. For more details about the study, see Teresa Sullivan et al., Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-91, 68 AM. BANKRUPTCY L.J. 121 (1994).
[118] 11 U.S.C. §§ 507(a)(7), & 523(a)(5).

earlier version of this legislation concluded that "child support and credit card obligations could be 'pitted against' one another. . . . Both the domestic creditor and the commercial credit card creditor could pursue the debtor and attempt to collect from post-petition assets, but not in the bankruptcy court."[119]

Outside of the bankruptcy court is precisely the arena where sophisticated credit card companies have the greatest advantages. While federal bankruptcy court enforces a strict set of priority and payment rules generally seeking to provide equal treatment of creditors with similar legal rights, state law collection is far more akin to "survival of the fittest." Whichever creditor engages in the most aggressive tactic – be it through repeated collection demands and letters, cutting off access to future credit, garnishment of wages or foreclose on assets – is most likely to be repaid. As Marshall Wolf has written on behalf of the Governing Counsel of the Family Law Section of the American Bar Association, "if credit card debt is added to the current list of items that are now not dischargeable after a bankruptcy of a support payer, the alimony and child support recipient will be forced to compete with the well organized, well financed, and obscenely profitable credit card companies to receive payments from the limited income of the poor guy who just went through a bankruptcy. It is not a fair fight and it is one that women and children who rely on support will lose."[120]

It is for these reasons that groups concerned with the payment of alimony and child support have expressed their strong opposition to the bill and its predecessors. Professor Karen Gross of New York Law School stated succinctly that "the proposed legislation does not live up to its billing; it fails to protect women and children adequately."[121] Joan Entmacher, on behalf of the National Women's Law Center, testified that "the child support provisions of the bill fail to ensure that the increased rights the bill would give to commercial creditors do not come at the expense of families owed support."[122]

Assertions by the legislation's supporters that any disadvantages to women and children under S. 256 are offset by supposedly pro-child support provisions are not persuasive. It is useful to recall the context in which these provisions were added. In the 105th Congress, the bill's proponents adamantly denied that the bill created any problems with regard to alimony and child support.[123] Although the proponents have now changed course, the child support and alimony provisions included do not respond to the provisions in the bill causing the problem – namely the provisions limiting the ability of struggling, single mothers to file for bankruptcy; enhancing the bankruptcy and post-bankruptcy status of credit card debt; and making it more difficult for debtors

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[119] CONGRESSIONAL RESEARCH SERVICE, IMPACT OF CONSUMER BANKRUPTCY REFORM PROPOSALS ON CHILD SUPPORT OBLIGATIONS (May 13, 1998).

[120] Statement of Marshall J. Wolf (May 13, 1998) (on file with the House Comm. on the Judiciary).

[121] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 87 (Mar. 18, 1999) (written statement of Karen Gross, Professor, New York Law School).

[122] *Id.* at 56 (testimony written statement of Joan Entmacher, National Women's Law Center).

[123] Letter from Representative George W. Gekas, et al., to Members of Congress (Apr. 29, 1998).

to eliminate debts and devote post-discharge income to the payment of domestic support obligations. In some instances, the new sections are counterproductive in furthering the goal of payment of support obligations to ex-spouses and children.

For example, section 211 provides a definition of "domestic support obligation" that includes funds owed to government units.[124] If the government is acting as the debt collector for a woman or child, this is appropriate; the benefits of this inure to women and children directly. However, if the government is collecting for its own benefit (say, for example, the woman recipient is on welfare and the government is collecting arrearages to reduce a state or Federal deficit), then the result is inappropriate and will put the government collection agency in direct competition with single mothers and children, particularly in chapter 13.[125]

Section 212 purportedly increases to first priority from seventh priority obligations for domestic support, including debts owed to the government. It is misleading to suggest that moving up to "first priority" from "seventh priority" makes a significant difference to a custodial parent seeking to collect child support: the debts that have second through sixth priorities almost never appear in consumer cases.[126]

In most consumer cases, the place of a creditor in the priority order is meaningless. In chapter 13, all priority debts must be paid in full.[127] In approximately 97% of all individual chapter 7 cases, the debtor has no non-exempt assets and so is unable to pay any priority or non-priority unsecured debts, regardless of their placement in the priority order. Outside bankruptcy, of course, the priorities in the Bankruptcy Code are inapplicable and unenforceable. It is in state court, after the case is over that the custodial parent must compete with newly non-dischargeable credit card debts. Being first priority is of no help.

Section 214 creates additional exceptions to the automatic stay[128] that, like other provisions in the bill, have the potential of placing women and children at a disadvantage. First, these provisions apply only to income withholding orders issued by government agencies under the Social Security Act, even though an estimated 40-50% of all child support cases, and all alimony-

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[124] Under current law, domestic support owed to families is a priority debt; support owed to the government is nondischargeable, but is not priority debt.

[125] Although the bill gives priority to support claims owed to actual people over those owed to the government in chapter 7 cases where there are assets to distribute, those cases are few, and the new definition could serve to hurt women and children, the most likely creditors of domestic support.

[126] Those priorities – which would likely apply in less than 1% of all cases – deal with debts of grain storage facility operators, debts of fishermen, employee wage claims, retail layaway claims, and the like. 11 U.S.C. § 507(a) (2000).

[127] *Id.* at § 11 USC 1322(a)(1).

[128] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. § 214 (2005)(proposed amendment to 11 U.S.C. § 362(b)). Specifically, the bill creates exceptions to the automatic stay for enforcement actions undertaken by government child support agencies, including income withholding in cases being enforced by public agencies; actions to withhold, suspend or restrict drivers', professional and occupational, or recreational licenses; reporting overdue support to credit bureaus; intercepting tax refunds; and enforcing medical support.

only cases, are enforced privately, not by government child support agencies. Second, income withholding is helpful only if such orders are placed against debtors with regular income. Yet, in 1997, more than four out of ten cases in state child support systems across the country lacked a support order.[129]

Section 216, which allows domestic support creditors to levy otherwise exempt homesteads and other exempt property, also does not go far enough. Like the other provisions, it is effective only if a single custodial parent goes to the time and expense of hiring an attorney to enforce her new rights.

The bill also fails to address the abuse of the bankruptcy system by individuals who systematically violate the constitutional rights of women to safe, legal reproductive health care, and the Freedom of Access to Clinic Entrances Act.[130]

Women and their health care providers must live with the fear that violent and reckless individuals will be able to terrorize and blockade abortion clinics, and seek to eliminate their liability from that action through the bankruptcy process. Although the current bankruptcy laws prevent discharge for "willful and malicious injuries,"[131] some have questioned whether the law applies to fines and judgements resulting for barricading clinic entrances or violating court orders that may fall short of that standard.[132] At the same time, notorious clinic bomber and "Operation Rescue" found Randall Terry specifically filed for bankruptcy in order to void a $1.6 million judgment he owed to the National Organization for Women and Planned Parenthood,[133] and many of the notorious "Nuremberg files" defendants have filed for bankruptcy.

Although a bankruptcy discharge has proved elusive for these law-breakers, they have succeeded in abusing the bankruptcy courts to hinder, delay and defraud the women whose rights they have violated, imposing substantial costs on them to collect lawful judgements. As NARAL Pro-Choice America has written, "[d]ebtors whose debts arise from their own clinic violence are not honest debtors and should not be able to escape the financial liabilities incurred by their illegal conduct."[134]

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[129] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 57, 60 (Mar. 18, 1999) (testimony and written statement of Joan Entmacher, National Women's Law Center) (citing U.S. DEPT. OF HEALTH AND HUMAN SERVS., OFFICE OF CHILD SUPPORT ENFORCEMENT, PRELIMINARY DATA REPORT: CHILD SUPPORT ENFORCEMENT FY 1997 (Aug. 1998)).

[130] 18 U.S.C. §248 (2004).

[131] 11 U.S.C. § 523(a)(6).

[132] KAWAAUCHAU V. GEIGER, 523 U.S. 57 (1998) (holding that the actor must intend the consequences of the act, injury to someone or something, not just the act, itself).

[133] *Operation Rescue Founder Files for Bankruptcy due to Lawsuits*, WASH. POST, Nov. 8, 1998, at A29; *An Anti-Abortion Leader Files for Bankruptcy*, N.Y. TIMES, Nov. 8, 1998, at 45.

[134] Memorandum of NARAL 8 (Mar. 30, 1999).

According to Maria Vullo, lead counsel for the plaintiffs in Planned Parenthood of the Columbia/Willamette, Inc. v. American Coalition of Life Activists, et al., No. 95-1671-JO (D. Or.), a case in which a Portland, Oregon jury, on February 2, 1999, awarded $109 million under FACE against the defendants for their illegal threats against the plaintiffs' lives, the defendants in that case have abused the protection of the bankruptcy courts in six districts to avoid paying those judgements.[135] Although none of the defendants have been able to obtain a discharge in those cases,

> In the now five years since the jury's verdict, my firm has committed enormous resources to enforcing the judgment, including by representing the plaintiffs in six different bankruptcy courts. In connection with these bankruptcy proceedings, the defendants took the position that the jury's verdict is fully dischargeable in bankruptcy, despite the "willful and malicious injury" exception to discharge that currently exists in the Bankruptcy Code. These filings, and the relitigation that has followed, demonstrate the utmost importance of an amendment to the U.S. Bankruptcy Code . . . . My firm expended over 3,500 attorney hours in litigating these bankruptcy proceedings, in addition to the time spent by local counsel in each jurisdiction and the substantial expense of filing fees, service fees, and travel around the country.[136]

Despite these abuses, the Senate rejected an amendment offered by Senator Schumer, that would have dealt with abuse of the bankruptcy system, not just with respect to violations of the Freedom of Access to Clinic Entrances Act, but any unlawful interference with the delivery of lawful goods or services.[137] Although the amendment had been adopted by substantial margins by the Senate in the past, opponents of the Schumer amendment argued that, regardless of the merits, it should be defeated in order to ensure passage of the larger bill.[138]

In Committee, Rep. Nadler offered an amendment that would have made non-dischargeable debts arising from violations of federal or state civil rights laws. It too was rejected. The Chairman of the Subcommittee, Mr. Cannon, made a similarly practical, if non-substantive, argument against the amendment:

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[135] *Hearing on S.256, the "Bankruptcy Abuse and Consumer Protection Act of 2005," Before the Senate Committee on the Judiciary, Hearing on Bankruptcy Reform*, 109th Cong. (February 10, 2005) (written statement of Ms. Maria Vullo, Partner , Paul, Weiss, Rifkind, Wharton & Garrison LLP).

[136] *Id.*

[137] *E.g.*, *Operation Rescue Founder Files for Bankruptcy due to Lawsuits*, WASH. POST, Nov. 8, 1998, at A29; *An Anti-Abortion Leader Files for Bankruptcy*, N.Y. TIMES, Nov. 8, 1998, at 145.

[138] "What is the practical reason? The House of Representatives rejected this bill the last time for the sole reason of the Schumer amendment. It is unbelievable. As much as we had in this bill, all the pages of this legislation, one little amendment killed this legislation, an amendment that I believe is bad policy, certainly not necessary, and I submit could result in killing this legislation again if we move it forward. So let's not do it. Let's not do this. Let's not go beyond the bill that we have now, that came out of the Judiciary Committee with a bipartisan vote, an overwhelming vote out of the Judiciary Committee to come to the floor without the Schumer amendment in it. Let's not add this amendment and jeopardize the passage of the bill." 151 CONG. REC. S.2207 (daily ed. Mar. 8, 2004) (statement of Sen. Sessions).

> This really, this amendment is just a revised version of the Schumer amendment, which has been responsible for scuttling the bankruptcy – passage of the entire bankruptcy bill for some time now. And it was defeated, this amendment was defeated in the Senate last week by a vote of 46 yeas and 53 noes.[139]

b. Minorities

S. 256 will have a disparate impact upon minorities. The Leadership Conference on Civil Rights has warned that "African American and Hispanic American homeowners are 500 percent more likely than white homeowners to find themselves in bankruptcy court largely due to discrimination in home mortgage lending and housing purchases, and to inequalities in hiring opportunities, wages, and health insurance coverage."[140] We know this because the economic struggle for Hispanic-American and African-American homeowners is harder than for any other group. While 68% of whites own their own homes, only 44% of African Americans and Hispanic Americans own their homes. Both African-American and Hispanic-American families are likely to commit a larger fraction of their take-home pay for their mortgages, and their homes represent virtually all their family wealth. Experience has also shown that minorities are also particular targets of predatory lenders. The LCCR also opposes this bill because it does nothing about the abusive practices used by the credit industry to saddle more people with debt. The LCCR states: "[S.256] also fails to address one of the key reasons that bankruptcy filings have increased in recent years . . . the aggressive marketing of credit cards to our most financially vulnerable citizens . . . ."[141]

c. Seniors

Similar concerns have been raised on behalf of seniors, who could lose their retirement savings if forced into chapter 13 plans.[142] The National Council of Senior Citizens has warned that legislation of this nature:

> [This legislation] would have a harsh impact on a group of people who are often subject to job loss or catastrophic health costs; instead of ameliorating these problems, this bill will only exacerbate them . . . . Since 1992, more than a million people over the age of 50 have filed for bankruptcy; in 2001, an estimated 450,000 older Americans filed. This number is up from the 180,000 that did so in 2001.[143] For seniors it is particularly hard. If they are forced into prolonged

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[139] *Markup of S. 256 before the House Comm. on the Judiciary*, 109th Cong. (Mar. 16, 2005) (statement of Rep. Cannon).
[140] Letter from Leadership Conference on Civil Rights, to Members of Congress (Mar. 14, 2005).
[141] *Id*.
[142] Letter from Dan Schulder, Director Legislation, National Council of Senior Citizens, to the Honorable Jerrold Nadler, Ranking Member, House Subcomm. on Commercial and Admin. Law (June 9, 1998) ([hereinafter Schulder letter].
[143] Lucretia Marmon, *Older Americans Going Deeper in Debt,* AARP BULL., Mar. 2003, *available at* http://www.aarp.org/bulletin/yourmoney/Articles/a2003-06-25-olderamericans.html.

repayment schedules, they may not be able to maintain or accumulate savings for retirement. As you know, approximately two-thirds of voluntary Chapter 13 workout plans fail, and we believe that retirement savings must be protected for that purpose.[144]

Furthermore, the Alliance for Retired Americans also opposes S. 256. They stated:

The fastest growing group of Americans filing for bankruptcy is those over 65. This unfortunate situation has been caused by skyrocketing health care costs that can drain a lifetime of savings in a very short period of time. In addition, many older Americans have seen their pensions and retirement savings disappear as well. The result has been that many older Americans cannot enjoy financial security in their retirement through no fault of their own. The legislation before the Senate actually increases the burden on older Americans who undergo financially difficult times through health care costs or loss of retirement income . . . . And while millions of older Americans have lost pension payments and retirement savings due to corporate abuses during the past five years, this legislation does nothing to make them whole or prevent future abuses.[145]

d. Victims of Crimes and Severe Torts

With regard to the concerns of victims' groups, it is important to note that current law reserves the nondischargeability of debts for obligations arising out of willful or malicious injury, death or personal injury caused by the operation of a motor vehicle, or criminal restitution payments.[146] However, making more credit card debt nondischargeable, encouraging more reaffirmations of general unsecured debt, and discouraging more financially troubled individuals from seeking debt relief will place these individual creditors at a relative disadvantage. As the National Organization for Victim Assistance has written, "more exempted creditors with rights to the same finite amount of resources means lower payments to all. Inevitably, for victim-creditors, that means either a smaller return on the restitution owed, or a longer period of repayment, or both."[147] The National Center for Victims of Crime has similarly observed, "to equate contractual losses of a commercial creditor with . . . personal obligations [for victim claims as the legislation does] is to belittle their importance and to directly reduce the likelihood that crime victims will ever be

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[144] Schulder letter.

[145] Letter from Edward Coyle, Executive Director, Alliance for Retired Americans, to Members of Congress (Feb. 28, 2005).

[146] 11 U.S.C. §§ 523(a)(6), (9), (13). (2004).

[147] Letter from Marlene A. Young, Executive Director, NOVA, to the Honorable Henry J. Hyde, Chair, House Comm. on the Judiciary (Apr. 26, 1999).

financially restored, despite obtaining an order of restitution or a civil judgment."[148] Mothers Against Drunk Driving ("MADD") has also complained that if "individuals [whose lives] have been shattered financially and emotionally by the death or serious injury of their family members . . . have to compete with credit card debt holders for the limited post-discharge income of debtors available [as the predecessor legislation requires], they may themselves end up in bankruptcy."[149] MADD also noted that in contrast to crash victims, "lending institutions have the ability to provide some degree of protection to themselves when they issue credit cards to individuals and they are in a better financial position to absorb losses, which to them is a cost of doing business."[150]

e. Victims of Identity Theft

S. 256 will also have a significant adverse impact on a growing number of identity theft victims who are forced into bankruptcy. In fact, the manager of the identity-theft program at the Federal Trade Commission commented a few years ago that not only can identity theft wreak havoc on the credit of a victim, but it can even force them into bankruptcy[151]. Since then, the problem has grown at epidemic rates, topping the list of consumer complaints filed with the FTC for the last four years in a row. In September 2003, the FTC released a comprehensive survey concluding that a staggering 27.3 million Americans have been victims of identity theft in the last five years - costing consumers and businesses an estimated $53 billion in 2002 alone.[152]

Recent news is rife with reports of identity theft scandals. Most notably, reports have revealed that identity thieves posing as legitimate customers gained access to ChoicePoint's database of 19 billion public records. The company has acknowledged that hackers had access to data on 145,000 people and that the stolen information has since been used in at least 700 identity theft scams.[153] In recent weeks, databases belonging to Lexis/Nexis were also compromised, with hackers stealing information on at least 32,000 people.[154] Even further, the University of California, Berkeley has revealed that a laptop containing the names and social security numbers of 100,000 people was stolen just this month[155].

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[148] Letter from David Beatty, Director of Public Policy, The National Center for Victims of Crime, to the Honorable Jerrold Nadler, Ranking Member, House Subcomm. on Commercial and Admin. Law (Apr. 28, 1999).

[149] Letter from Karolyn V. Nunnallee, National President, MADD, to Members of Congress (Apr. 26, 1999).

[150] *Id.*

[151] Kirstin Downey Grimsley, *Social Insecurity Numbers*, WASH. POST, Dec. 8, 1999, at E1.

[152] FEDERAL TRADE COMMISSION, IDENTITY THEFT SURVEY REPORT 7, 12 (2003) *available at* http://www.ftc.gov/os/2003/09/synovatereport.pdf.

[153] Rachel Konrad, *The High Cost of Id Theft: Pressure is Mounting Nationally for Securing Personal Data*, PHILA. INQUIRER, at E2.

[154] Ellen Simon, *Hackers Enter Database for 32,000 in U.S.*, PITTSBURGH POST-GAZETTE, at C12.

[155] Todd R. Weiss, *Laptop with 98,000 Names Stolen at UC-Berkeley*, March 29, 2005 *at* www.computerworld.com.

In all of these cases, criminals have an opportunity to use victims' identities to apply for credit cards, acquire loans and make exorbitant purchases.[156] However S 256 creates an arbitrary means tests that does nothing to distinguish between the creditor claims related to crimes of identity theft and legitimate debt incurred by the debtor. Even if more than 51 percent of the creditor claims in bankruptcy are the result of identity theft, the debtor will still be subject to the unfair and arbitrary means test and forced out of the protections of Chapter 7.

Congressman Schiff offered a narrowly tailored amendment during the mark-up of S. 256 to directly address the plight of identity theft victims forced into bankruptcy. The Schiff amendment required that if at least 51% of the claims against a debtor in bankruptcy are a result of identity theft, the debtor should not be forced out of the protections of Chapter 7. The majority was unable to state any clear reason to oppose this simple amendment and even acknowledged that it was an "an important idea"[157]. However, the amendment was narrowly defeated in a party line vote 13-15.

f. Military

S. 256 will have an unfair impact on military families who serve this country by imposing an arbitrary means test on these brave men and women that will prevent many from receiving needed debt relief. In the of conflicts in Iraq and Afghanistan, military families and veterans have faced unusual financial stress because of the large numbers of reserve and guard units that have been mobilized. These financial hardhips have a number of significant causes.

First, military service constitutes a significant and real hardship for soldiers and their families. Groups such as The National Military Family Association and Military Officers Association of America report hearing from many servicemembers in the Guard and Reserve who have made special sacrifices when called to duty, particularly when they own their own business and have experienced hardships with that business while they were deployed. According to a 2004 GAO report, in 1999, 16,000 active duty members of the military filed for bankruptcy relief over a 12-month period.[158] With our military extended from Iraq to

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[156] News stories highlight the extent of the personal damage caused by identity theft crimes. A man was sentenced in New York to two years in prison for using a former girlfriend's identity to commit fraud. The scheme lasted several months, during which the perpetrator took out three personal loans in the victim's name and purchased an Audi and a large Chevrolet pickup truck. Ultimately, the fraud resulted in the theft of over $300,000, forcing the victim to declare bankruptcy. *See* Carol DeMare, *Man gets prison for $300,000 identity fraud*, ALBANY TIMES-UNION, Feb. 8, 2005, at B4; *see also Avonmore woman has identity stolen*, GREENSBURG TRIBUNE-REVIEW, November 30, 2004.

[157] Representative Cannon stated during debate on the Schiff amendment, "its obvious to me that its an important idea and maybe something we would want to consider in the context of future changes . . . ." Representative Cannon continued later that he encouraged his colleagues to oppose the amendment because it would "clearly disrupt the whole process of moving forward a bill."

[158] U.S. GENERAL ACCOUNTING OFFICE, MILITARY PERSONNEL: BANKRUPTCY FILINGS AMONG ACTIVE DUTY SERVICE MEMBERS, GAO-04-465R (2004).

Afghanistan, and reservists separated from their families and jobs for long stretches of time, that number has undoubtedly increased greatly today. The Pentagon reported in 2002 that nearly one-third of all military families reported a drop in income when a spouse was deployed. For members of the National Guard and Reserve, the rate was even higher – more than 40% reported lost income when a spouse was deployed.[159]

There is little doubt that servicemembers are suffering financial hardships because of service to their country. Guardsmen and reservists who are also small business owners and employees of small companies often suffer grievous setbacks, as their carefully built companies lose business, struggle to survive, or simply shut their doors.[160] Notwithstanding protection afforded military members and their families through other Federal laws, many find that their financial problems still become so severe that they have no choice but to file for bankruptcy.[161]

Second, active-duty military members and their families' hardships are compounded by unscrupulous pay-day lenders who target armed service members with high-interest loans. A 2003 National Consumer Law Center Report found that "scores of consumer-abusing businesses directly target this country's active duty military men and women daily." These pay-day lenders are modern-day loan sharks, that offer small short-term loans at interest rates of 100, 500, even 1000%. They use deceptive names like "Force One Lending," and "Armed Forces Loans." They go after military members because they know that they: have a steady source of income, are young, have family obligations, are often strapped for cash, and are

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[159] U.S. GENERAL ACCOUTING OFFICE, DOD NEEDS MORE DATA TO ADDRESS FINANCIAL AND HEALTH CARE ISSUES AFFECTING RESERVISTS, GAO-03-1004 (003).

[160] Dave Moniz, *Guardsmen, Reservists Hit Hard at Home by Call-ups*, USA TODAY, Feb. 6, 2005.

[161] The Servicemembers Civil Relief Act, signed into law, December 2003, protects all active duty military families from foreclosures, evictions and other financial consequences of military service. Yet due to the increased reliance on Reserve and National Guard units from non-traditional military towns, the members find themselves facing creditors and courts that may never have dealt with the relief act. In addition, the burden of enforcement is on the service members themselves to show that he or she has been "materially affected" by being called to duty, and ends as soon as the duty ends, and the Act applies only to debts incurred before the Servicemember was mobilized. The impact of the mounting debts while the servicemember is overseas and the family business founders are not covered, yet these are the ones driving many families into bankruptcy. Unlike the bankruptcy laws, the Relief Act buys some time, but not forgiveness. The servicemember finds themselves without the time and money to fight back when they are getting ready for overseas duty. Diana B. Henriques, *Some Creditors Make Illegal Demands on Active-Duty Soldiers,* N.Y. TIMES, Mar. 28, 2005.

Another means of protection for servicemembers is the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) which protects the re-employment rights of service members or veterans upon their return to civilian life from active duty. On March 20, 2005 the DOJ announced the signing of a consent decree, resolving a lawsuit against Bridgestone/Firestone North American Tire, LLC filed to protect the rights of a national guardsman returning from active duty. Bridgestone agreed to provide employment benefits to the returning national guard member. While we are encouraged by the successful enforcement of this law by the DOJ, it is important to note that a large number of national guardsmen and reservists are self-employed and therefore without legal re-employment rights and judicial recourse. Press Release, Department of Justice, Justice Department Reaches Agreement with Bridgestone/Firestone Over Employment Benefits for National Guardsman (March 29, 2005) (on file with author).

easy to find. Most offensive, payday lenders target military members because they know these are people who are hard-working and honest and believe in personal responsibility and integrity.

To a servicemember's great detriment, S. 256 does not prevent a creditor from recovering in bankruptcy amounts owed on a high-cost payday loan made to a servicemember or a dependent secured by a personal check for future deposit or electronic access to a bank account. The bill would also permit claims based on a debt that requires payment of interest, fees, or other charges which would cause the annual percentage rate to exceed 36%. In addition, lenders who provide servicemember loans at exorbitant interest rates can obtain an assignment of military retirement and disability payments. It is unconscionable that these lenders can lawfully take military retirement and disability payments from the people who spend months often years away from home to protect our nation.

An amendment offered by Sen. Durbin reflected an understanding that service men and women who have been mobilized and are serving in Iraq, Afghanistan, and in the war on terror are paying a terrible price in the economic well being of their families, in addition to the heavy burdens they have been asked to shoulder. Senator Durbin's amendment would exempt disabled veterans filing from dismissal or conversion of their ch. 7 petition under the means test if their indebtedness occurred primarily while on active duty or performing a homeland defense activity. Congressman Meehan offered a broader version of the Durbin amendment by exempting disabled service members who accumulated, amounted debt after their return home as well as those whose indebtedness was due to their injury or the disability sustained while on active duty. The amendment was rejected with 12 ayes and 19 noes.

Senator Sessions offered a "Military and Medical" amendment which simply inserts "such as a serious medical condition or a call or order to active duty in the Armed Forces" as examples of *special circumstances* that would allow adjustment of income or expenses. Senator Sessions did not offer a solution to the problem as the Durbin and Meehan amendments did but merely reiterated *special circumstances* that were already allowed by the bill.

In an effort to build on Sen. Durbin's effort, Rep. Conyers offered an amendment to crack down on unscrupulous and usurious payday lenders who prey military members with deceptive, high interest rate loans. The amendment would have disallowed a claim based on an extension of credit made and secured by a military paycheck, pension, or disability payment where the annual interest rate and fees exceed 36 percent a year. The amendment was rejected with 15 ayes and 20 noes.

We believe that Congress can provide greater support for military families suffering economic distress as a result of their service to our nation. Many servicemembers are unable to return to their jobs because of physical or psychological injuries. To date, more than 11,000 servicemembers who served in Iraq and Afghanistan have been wounded. The means test in this bill establishes completely arbitrary expenses that have nothing to do with the types of new expenses a disabled servicemember might actually be facing. If any group of people deserves some relief from this burdensome means test process, it is America's disabled veterans who suffered both physical and financial devastation while they were wearing a military uniform.

Whether returning home disabled or not, servicemembers oftentimes face their greatest challenges within the two years after their service is completed rebuilding their families, their businesses, and their finances in general. These men and women struggling to get their lives back in order after serving their country need to be exempted from the means test if they were called or ordered to active duty since 9/11 and then forced to file for bankruptcy as a direct result of their military service within 24 months of being released from duty. We cannot repay the debt we owe these men and women, but we can protect them from having to spend the rest of their lives in debt.

5. The Bill Does not Address Abuses of the Bankruptcy System by Creditors

Perhaps the bill's most glaring omission is its failure to address seriously the problem of abusive lending practices. At the same time the legislation responds to scores of alleged debtor excesses – whether real or imagined – it largely ignores the transgressions of the credit industry. The only significant "reform" with regard to lending industry disclosure is that requirement that credit card companies provide the consumer with an "800" number to call and unrealistic examples of credit card debt paydowns (which may not reflect the actual situation of the debtor and thus prove misleading), as well as a series of boilerplate warnings regarding real estate loans and teaser rates.[162]

As noted at the outset, the overwhelming weight of authority establishes that it is the massive increase in consumer debt, not any change in bankruptcy laws, which has brought about the increases in consumer filings. Indeed, there is an almost perfect correlation between the increasing amount of consumer debt and the number of consumer bankruptcy filings. For example, credit card debt more than tripled between 1989 and 2001 from $238 billion to $692 billion, and personal bankruptcy filings increased accordingly.[163] The same basic correlation holds from 1946 through 1998, as the below chart indicates.

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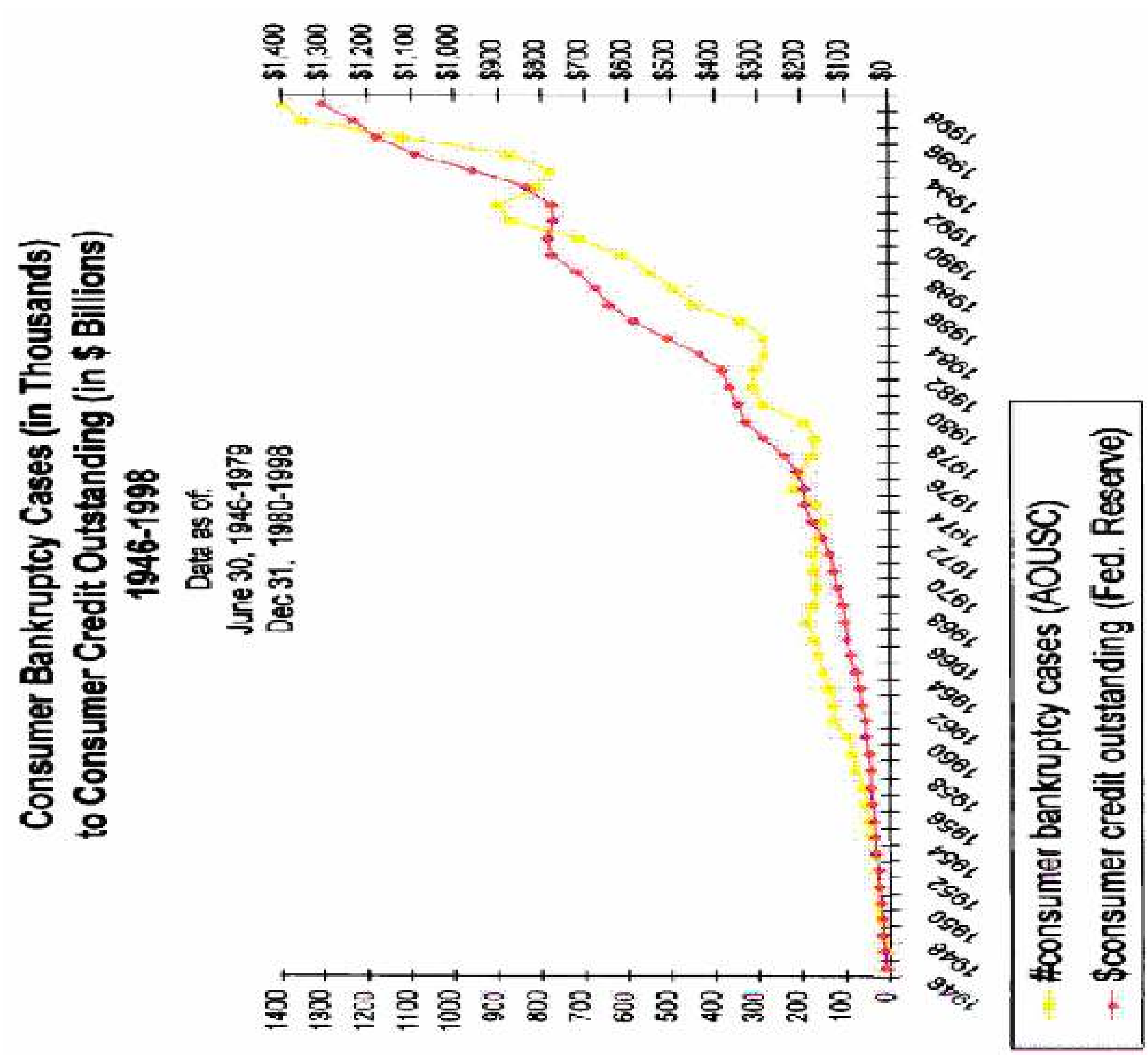
[162] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256, 109th Cong. § 1303 (2005).

[163] *See* TAMARA DRAUT & JAVIER SILVA, DEMOS: A NETWORK FOR IDEAS AND ACTION, BORROWING TO MAKE ENDS MEET: THE GROWTH OF CREDIT CARD DEBT IN THE 90S 9 (2003) *available at* www.demos-usa.org



Review of this data indicates that the primary factor that led to the increase in bankruptcy filings after 1978 was not the enactment of the revised bankruptcy laws, but the deregulation of credit. The deregulation resulted from the Supreme Court decision in *Marquette National Bank of Minneapolis v. First Omaha Service Corp.*, which held that out-of-state banks were not subject to the usury laws of the state where the consumer was located.[164] This decision led credit card companies to relocate to states with lax usury laws that gave banks the ability to charge exorbitant interest rates in all 50 states. Subsequently, other legal changes permitted a broad range of new entities to get into the ever-growing, and lucrative, credit card business.[165] Among other things, we know that it was this unprecedented increase in high-cost credit, not the changed bankruptcy laws, that led to the change by virtue of Canada's experience. In Canada, bankruptcy filings began to explode in the late 1960's, simultaneous with the entry of VISA and MasterCard into that nation and the growth in credit card lending. There was no change in Canada's laws that could account for the increase.[166]

This deregulation of credit and the accompanying explosion in credit availability – the number of credit card solicitations in 2004 reached 5 billion – and in consumer debt, have been accompanied by a wide variety of abusive credit card practices, including ever growing fees and penalties. As the *Wall Street Journal* pointed out in a July 6, 2004 article, "[c]ard users, consumer advocates and some industry experts complain that banks are attempting to squeeze more and more revenue from consumers struggling to make ends meet. Instead of cutting these people off as bad credit risks, banks are letting them spend – and then hitting them with larger and larger penalties for running up their credit, going over their credit limits, paying late and getting cash advances on their credit cards."[167]

Cardweb.com, a consulting group that tracks the card industry, says credit-card fees, including those from retailers, rose to 33.4 percent of total credit card revenue in 2003. That was up from 27.9 percent in 2000 and just 16.1 percent in 1996. A November 21, 2004 *New York Times* article also examined credit card practices and concluded that "In the last few years, lenders have more frequently raised customers' rates because of slip-ups elsewhere, like late payment of a phone or utility bill, or simply because they felt a customer had taken on too much debt . . . . To some cardholders and consumer advocates, credit card companies are acting like modern-day loan sharks, strong-arming their customers to pay more – with no legal limit on how much they can charge."[168]

Credit card companies even go so far as to solicit business from the developmentally disabled.[169] One developmentally disabled man, aged 35, has the reading and mathematic skills of a second-grader and an annual income of $7,000 from Social Security disability benefits;

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[164] Marquette Nat'l Bank of Minneapolis v. First Omaha Serv. Corp., 439 U.S. 299, 313, 318 (1978).

[165] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 226 (Mar. 16, 1999) (written statement of Joe Lee). *See March 16, 1999 Hearing* (written statement of Hon. Joseph Lee at 1S3).

[166] *Id.* at 227. (written statement of Hon. Joseph Lee at 4S5).

[167] Michelle Pacelle, "Fees From Riskiest Card Holders Fuel Profits: Late Payers and Big Borrowers are Becoming Cash Cows as Rates Balloon," Michelle Pacelle, WALL ST. J., July 6, 2004.

[168] Patrick McGeehan, "The Plastic Trap: Soaring Interest Compounds Credit Card Pain for Millions," Patrick McGeehan, N. Y. TIMES, November 21, 2004.

[169] Dan Herbeck, *Where Credit Isn't Due: Developmentally-Disable Become Victims*, BUFF. NEWS, Apr. 7, 1998, at 1A.

nevertheless, he has 13 credit cards, generating a debt of $11,745.[170] When his counselor asked the bank to lower his credit limit to $500, his limit was instead raised to $4,900.[171] Credit card companies have no answer for how this occurs other than to say that they screen all applicants to ensure they can handle the risk.[172] Clearly, however, credit card companies have not been doing a sufficient job of screening their applicants. Unfortunately, S. 256 does nothing to discourage any of these practices.

The bill also ignores the problem of credit card companies lending to individuals with already substantial debts and little prospect of repayment. Gary Klein of the National Consumer Law Center noted "offering additional credit . . . to families already struggling to pay their debts hurts not only borrowers, but also the borrowers' honest creditors if the new credit pushes the family over the edge. Similarly, failure by one creditor to seriously consider payment arrangements outside bankruptcy for families facing hardship may lead to a bankruptcy filing which affects all creditors."[173] One credit card company goes so far as to solicit debt counselors and offers them $10 for each chapter 7 client who requests a credit card.[174]

A particularly pernicious credit card practice occurs in the so-called "subprime" market, where lenders seek out riskier borrowers and offer home equity financing at loan to value ratios in excess of 100%. Another lending abuse targets low-income and minority neighborhoods with "serial" refinancing loans that carry high-interest rates and other onerous terms.[175] In essence this causes poor individuals to place their homes at risk in order to finance their credit card purchases.

These problems are compounded by the fact that credit card companies fail to disclose clearly on their account statements the total amount and total time it would take to pay off balances if only the consumer only paid the minimum amount due was paid each month. Unlike mortgage loans and car loans, credit card loans do not disclose the amortization rates or the total interest that will be paid if the cardholder makes only the minimum monthly payment. As a result, using a typical minimum monthly payment rate on a credit card, it could take 34 years to pay off a $2,500 loan, and total payments would exceed 300 percent of the original principle. This is why many lenders encourage minimum payments that do not pay down the loan.

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[170] *Id.*

[171] *Id.*

[172] *Id.*

[173] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 120 (Mar. 11, 1999)(written statement of Gary Klein, National Consumer Law Center).

[174] Letter from American Bankruptcy Service, to Michael Schwartz (Dec. 18, 1998).

[175] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 240 (Mar. 18, 1999) March 18, 1999 Hearing (written statement of Damon A. Silvers, AFL-CIO, n.9) ([citing Debra Nussbaum, "*Lenders Laud the Value of Home Sweet Equity*," N.Y. TIMES, Mar. 22, 1998, § 3 at 10; Richard W. Stevenson, "*How Serial Refinancings Can Rob Equity*," N.Y. TIMES, Mar. 22, 1998, § 3 at 10). *See also* Julia Patterson Forrester, "*Mortgaging the American Dream: A critical Evaluation of the Federal Government's Promotion of Home Equity Financing*," 69 TUL.LANE L. REV. 373 (1994).

Finally, the legislation fails to address adequately the problem of abuse in the area of reaffirmation agreements, by for example, placing effective and meaningful restrictions on their use with respect to unsecured and dischargeable loans. Although it requires lengthy and confusing "disclosures," it exempts credit unions from any restrictions on unduly burdensome reaffirmations, defined as requiring the debtor to make monthly payments in excess of 100% of the debtor's post-discharge monthly disposable income.[176] This failing is especially glaring in view of the fact that the bill will provide numerous opportunities for creditors to coerce reaffirmations making the provisions of this bill, which will render it more difficult to obtain effective remedies against abusive creditors like Sears, even less defensible.[177]

Neither the witness representing the Credit Union National Association, nor any proponent of the bill, has ever attempted to explain why a credit union should be permitted to reaffirm a debt requiring payments that, as a matter of simple arithmetic, the debtor will be unable to pay. This provision is unconscionable and runs counter to the historic commitment of credit unions as defenders of the rights of their members.

III. BUSINESS AND SINGLE-ASSET REAL ESTATE PROVISIONS

Under current law, businesses may use chapter 11 of the Bankruptcy Code in an effort to obtain relief from the creditors while they seek to develop a plan to reorder their affairs and pay as much of their debts as their operations will allow. Under this chapter, businesses obtain an "automatic stay," which forestalls creditor collection efforts. During this time period, debtors have an opportunity to examine their contracts and leases and determine which ones to assume and which ones to reject (with rejection leading to a claim for damages). Debtors are subject to a number of requirements during this period, such as the formation of creditor committees and various ongoing financial disclosures.

"By permitting reorganization, Congress anticipated that the Business would continue to provide jobs, to satisfy Creditors claims and to Produce a return for its owners .... Congress presumed that the asset of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.'" *United States v. Whiting Pools, Inc.*[178]To this end, the debtor is given an exclusive 120-day period (unless lengthened or shortened for cause) in which to develop a reorganization plan that satisfies a host of statutory requirements and convince a majority of the creditors that the plan is in their best interests and is preferable to a liquidation "fire sale."

In 1994, Congress enacted two exceptions to the general rules of chapter 11. The first related to "small businesses," defined as entities engaged in commercial or business activities whose aggregate debts do not exceed $2 million. Debtors that elect to be treated as small

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[176] S. 256, § 203(a) (creating a new 11 U.S.C. § 524(m)).

[177] *See* Leslie Kaufman, *Sears to Pay Fine of $60 Million in Bankruptcy Fraud Lawsuit,* N.Y. TIMES, Feb. 10, 1999, at C2.

[178] 462 U.S. 198, 203 (1983).

businesses are permitted to dispense with creditor committees, receive only a 100-day plan exclusivity period, and are entitled to more flexible provisions for disclosure and solicitation for acceptances of their proposed reorganization plan.

In 1994, Congress also developed a special set of rules applicable to "single asset real estate," generally defined as cases in which the principal asset is a single piece of real estate subject to debt of no more than $4 million. In cases falling within this definition, secured creditors are permitted to foreclose on their collateral unless the debtor files a reorganization plan which is likely to be confirmed or commences payment on the secured loan within a 90-day period. This exception to chapter 11 procedures was justified on the grounds that single- asset real estate cases were seen as essentially private two-party loan disputes, which did not implicate ongoing businesses or jobs.

A. Business Provisions

The business provisions of the bill would effectuate a number of changes in the manner in which corporations, partnerships, and other business entities are permitted to reorganize their financial affairs. With respect to small business, S. 256 would expand the definition of covered small business to those companies having debts of not more than $2 million,[179] subsuming more than 80% of all chapter 11 cases.[180] It would also make the small business requirements mandatory (rather than optional) and mandate the operation of numerous additional requirements on debtors.[181] For example, under S. 256, small business debtors would be required to provide balance sheets, statements of operations, cash-flow statements, and income- tax returns within three days after filing a bankruptcy petition, the time period the debtor has the exclusive right to file a plan of reorganization would be modified (to 180 days without the possibility of extension), and the standards for being able to seek an extension of this time period would be substantially narrowed.[182]

It is for these reasons that the AFL-CIO, and a number of other organizations representing both debtor and creditor interests have opposed, or have serious concerns with, the small business provisions of the bill. The AFL-CIO warned that the small business provisions in the bill will "threaten jobs by placing substantial procedural and substantive barriers in the way of small businesses' access to the protections of Chapter 11 . . . . threaten jobs by requiring commercial debtors to assume or reject commercial leases within a rigid timetable, which would force debtors to favor one class of creditors over others, and threaten their overall ability to successfully

[179] S. 256, § 432 (proposed amendment to 11 U.S.C. § 101(51D)).

[180] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 255 (Mar. 18, 1999)(written statement of Jere W. Glover, Chief Counsel for Advocacy, SBA).

[181] S. 256, § 436 (proposed 11 U.S.C. § 1116).

[182] S. 256, § 437 (proposed amendment to 11 U.S.C. § 1121(e)).

reorganize."[183] All of these concerns are compounded at a time we are experiencing an economic slowdown, if not an outright recession.

> "[T]he bill does little to address the devastating effects of the past seven years of business bankruptcies on workers. During this period, worker shave sustained unprecedented job loss, endured the termination of pension plans, and faced wage cuts, elimination of health care and other benefits, often all in the same bankruptcy case."[184]
>
> This new bankruptcy mandate, particularly sections 437 through 439, would impose substantial new costs on small businesses, both in terms of document production and legal fees, and limit the time frame that the business has to develop a reasonable reorganization plan.[185] Section 437 provides an absolute limit on the period the business debtor has the exclusive right to file a plan of reorganization. Congress has previously enacted laws that have made it far more difficult for debtors to unduly delay filing a plan of reorganization, and these appear to have had a salutary effect. The proposed rigid deadline goes much farther and could work to detriment of debtors involved in complex reorganizations and force unnecessary liquidations and job losses. In turn, these changes will lead to the premature liquidation of small businesses with the attendant loss of jobs. The provisions are particularly unnecessary at a time when business bankruptcies have declined by one-third over the most recent ten-year period.[186]

Describing the earlier version of the bill, the SBA's Office of Advocacy summed up the situation as follows: "the proposals in [the legislation] go too far in addressing the relatively small number of problem cases."[187] Even more dangerously, it has been noted that many – if not most –

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[183] Letter from Peggy Taylor, Director of Legislation, AFL-CIO, to the Honorable Henry J. Hyde, Chair, House Comm. on the Judiciary (Apr. 20, 1999).

[184] Letter from American Federation of Labor and Congress of Industrial Organizations, American Federation of State and County Municipal Employees (AFSCME), American Federation of Teachers, Communications Workers of America, International Association of Machinist and Aerospace Workers, International Brotherhood of Boilermakers, Iron Shipbuilders, Blacksmiths and Forgers, International Brotherhood of Electrical Workers, International Brotherhood of Teamsters, International Union, United Automobile, Aerospace and Agricultural Workers of America (UAW), Laborers International Union of North America, National Association of Government Employees, Air Line Pilots Association, PACE International Union, Service Employees International Union, United Food and Commercial Workers International Union, United Mine Workers of America, United Steel Workers of America, and UNITEHERE, to Members of Congress (Feb. 28 2005).

[185] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 256 (Mar. 18, 1999) *March 18, 1999 House Judiciary Committee Hearing* (written statement of Jere W. Glover, Chief Counsel for Advocacy, SBA).

[186] Letter from Jere W. Glover, Chief Counsel for Advocacy, U.S. Small Business Administration, to the Honorable Jerrold Nadler, Ranking Member, House Subcomm. on Commercial and Admin. Law (Apr. 22, 1998).

[187] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 253 (Mar. 18, 1999)(written statement of Jere W. Glover, Chief Counsel for Advocacy, SBA).

of the business cases in the average district would fall prey to these harsh new rules.[188]

Prof. Douglas Baird has studied small business bankruptcies and reports:

> S. 256 imposes many new burdens on small business. The justification for singling them out rests upon an unsound empirical assumption that Chapter 11 offers a haven for failing small business and allows them to die a lingering death. Based on our study of practices int eh Northern District of Illinois, we believe the realities of small business bankruptcies today simply do not support this assumption
>
> More than half of small business Chapter 11 cases that fail (i.e., those that are dismissed or converted to Chapter 7 liquidations) are terminated within four months of filing. Over 70% are terminated within 6 months. By 300 days, the deadline for filing a plan under §347, 90% have already left the system. The burdens that S. 256 imposes fall not upon the Chapter 11 debtors that are going to fail, but rather on those that are likely to succeed. Nearly 40% of these, the ones Chapter 11 is intended to help, need more than 300 days to put their plans in place.
>
> By the time the deadlines of S. 256 take effect, the vast majority of failing firms have long since been weeded out. The burdens fall disproportionately on exactly he wrong debtors – the viable firms Chapter 11 is intended to help[189].

B. Single-Asset Real Estate Provisions

A similar concern relates to single-asset real estate ("SARE") debtors. The legislation would significantly expand the definition of SARE by eliminating the $4 million debt cap pursuant to a "technical correction" in section 1201(5) of Title XIII of S. 256, would take in SARE bankruptcies below that cap and treat them as small businesses.

As a result of these changes, a much wider range of real estate operations would be required to conform with the SARE and small business requirements when they seek to reorganize, notwithstanding the fact that those requirements were drafted with a much smaller and simpler entity in mind. Large operating entities such as Rockefeller Center, as well as hotels and nursing homes, could be considered SARE and put back on the track set forth in section 362(d)(3) of the Bankruptcy Code. It would also create new incentives for lenders to require that all of their real estate borrowers place their holdings in the single asset form in order to avoid ordinary bankruptcy rules in the future. The AFL-CIO noted, "the significant limiting factor in the application of these rules has been the $4 million cap. [Eliminating] the cap would place a wide variety of properties . . . at risk of foreclosure and threaten jobs at these properties. Absent rules

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188 *Id.* at 232 (written statement of Damon A. Silvers, AFL-CIO at 4); *Id.* at 105 (March 17, 1999) (written statement of Kenneth Klee, National Bankruptcy Conference).

189 Letter from Douglas G. Baird, Harry A. Bigelow Distinguished Service Professor of Law, University of Chicago School of Law to Senator Russell D. Feingold (Feb. 16, 2005).

that specifically exclude properties such as housing and those with significant business enterprises, there should be no expansion in the definition of single-asset real estate debtor."[190]

By design, the SARE changes will "broaden the scope of single asset real estate debtors subject to rules which increase the threat of disruptive summary foreclosures of commercial property."[191] This, in turn, would likely lead to significant job losses.[192] Even if a hotel or nursing home remains in existence, the new owner would not necessarily be required to honor any previously negotiated collective-bargaining agreements applicable to employees at the facility. In the case of a large real estate operation, premature foreclosure could also allow the new owner to terminate many leases, leading to further job losses to the extent the business is relying on these leases.

C. Failure to Safeguard Employee Rights and Stem Corporate Abuses.

While S. 256 unfairly penalizes small companies and real estate entities and their employees, it gives a pass the very real abuse of large corporate debtors.

Testimony presented before the Senate Judiciary Committee hearing described the devastating impact corporate bankruptcies often have on the financial well-being of the workers and retirees associated with the companies. Indeed, many of the largest corporate bankruptcy cases in American history have occurred in the eight years since this bankruptcy bill first was written. Some of those cases already are legend for the corporate scandals that accompanied them.

Because it was written eight years ago, S. 256 does precious little to deal with these abuses and the all too often painful consequences for workers and retirees who have their pension plans and health benefits cancelled during the course of a corporate restructuring. Corporate collapses such as Enron, Worldcom, Adelphia and Polaroid have become all too common. Current bankruptcy laws are inadequate to address the resulting financial woes imposed on workers, retirees and stockholders. This bill has no meaningful response to the rise in corporate bankruptcy abuses.

The United Steelworkers of America observed that the bill does nothing to stem the rapid loss of pension benefits for members and retirees:

> In the steel industry alone, 45 steel companies have filed for bankruptcy since 1997. This has left over 250,000 USWA members and retirees with greatly reduced pensions and the burden of paying out-of-pocket medical expenses, which the Center for American Progress (CAP) has found to be one of the key factors that

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190 *Id.* at 237 (written statement of Damon A. Silvers, Associate General Counsel, AFL-CIO).

191 Letter from Peggy Taylor, Director of Legislation, AFL-CIO, to the Honorable Henry J. Hyde, Chair, House Comm. on the Judiciary (Apr. 20, 1999).

192 *Id.*

> consistently leads to personal bankruptcy. We strongly feel that this legislation needs to address the effects corporate bankruptcies have on workers and retirees.[193]

According to a coalition of twenty unions,

> Provisions affecting business bankruptcies fare no better. Packed with terms that are tailored to well-funded creditor interests, the bill does little to address the devastating effects of the past seven years of business bankruptcies on workers. During this period, workers have sustained unprecedented job loss, endured the termination of pension plans, and faced wage cuts, elimination of health care and other benefits, often all in the same bankruptcy case. They have watched businesses disappear from their communities. No sector of the economy has escaped. Bankruptcies have plagued over 45 steel companies and countless other manufacturing, retail, service, energy, mining, transportation, textile and telecom businesses since the time the bill was first introduced.
>
> *Real* bankruptcy reform would fix an inadequate wage priority which subjects workers' wages and benefits to arbitrary payment rules. Real bankruptcy reform would rationalize the treatment of claims by injured workers. Real bankruptcy reform would fix the asset sale rules to prevent companies from simply walking away from retiree health care. S. 256 does none of these things. If the goal is bankruptcy reform, then S. 256 needs a lot of work and a lot more time. Congress needs to take an in-depth look at bankruptcy legislation and address the need for reform as it exists now, not as it existed eight years ago.[194]

D. Other Business Concerns

A host of additional concerns have been raised by groups such as the AFL-CIO and the National Bankruptcy Conference regarding the business titles of the legislation. These include concerns about the expansion of remedies available to secured creditors in the transportation industry;[195] the imposition of mandatory deadlines for extensions of "exclusivity";[196] limits on

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[193] Letter from William J. Kleinfelter, Assistant to the President, United Steelworkers of America to Members of the U.S. Senate (Feb. 28, 2005).

[194] Letter from American Federation of Labor and Congress of Industrial Organizations; American Federation of Sate and county Municipal Employees (AFSCME); American Federation of Teachers; Communications Workers of America; International Association of Machinist and Aerospace Workers; International Brotherhood of Boilermakers, Iron Shipbuilders, Blacksmiths and Forgers; International Brotherhood of Electrical Workers; International Brotherhood of Police Officers; International Brotherhood of Teamsters; International Union, United Automobile, Aerospace and Agricultural Workers of America; Laborers International Union of North America; National Association of Government Employees; Air Line Pilots Association; PACE International Union; Service Employees International Union; United Food and Commercial Workers International Union; United Mine Workers of America; United Steel Workers of America; and UNITEHERE to Members of the U.S.Senate (Feb. 28, 2005).

[195] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 235 (Mar. 18, 1999). *March 18, 1999 House Judiciary Committee Hearing* (written statement of Damon A. Silvers, AFL-CIO); March 17, 1999 Hearing (written statement

subsequent filings for troubled small businesses,[197] and provisions giving utility companies an enhanced position in bankruptcy.[198] In general, the AFL-CIO has warned that "the real danger posed by H.R. 3150 [an earlier version of S. 256] is the threat it poses to our economy's ability to weather downturns. The bill aims to make access to the bankruptcy process more difficult for our economy's most vulnerable links – small businesses and consumers. This will likely result in increased business closures, job loss and home foreclosure, increasing the severity and length of any future economic downturn."[199]

Similar concerns relate to the power of creditors who lease retail property. Section 404 unfairly grants lessors of commercial property the ability to coerce debtor-tenants into deciding prematurely whether to assume or reject a lease. In a retail insolvency, a debtor may need to wait beyond the 210-day period – 120 days with the ability to gain a 90-day extension upon a motion for cause and with the lessor's consent – until the holiday season is complete to determine which locations have a realistic chance to succeed; a trustee or debtor in possession may decide to assume and reject some of the leases based upon this practical experience.[200] If the trustee or debtor in possession assumes a nonresidential lease in chapter 11, and the case subsequently converts to chapter 7, under the bill, the rent due for a one-year period following rejection of the lease becomes an administrative expense for compensation, gaining priority over all other unsecured claims and limiting the opportunity for other unsecured creditors to receive compensation.[201] By giving the lessor veto power at the end of 210 days, as the bill now does, the legislation would have the effect of giving a single creditor inordinate bargaining power among creditors and with the debtor.

Another problematic provision appears in section 442 of S. 256. Section 442 amends section 1112(b) of the Code to expand the grounds on which the court can dismiss or convert a small business case. For example, a case will be presumptively dismissed when the debtor fails to comply with a lengthy list of requirements. To overcome the presumption, the debtor must show that a reasonable justification exists for the debtor's action, that the debtor will rectify the situation within a reasonable time prescribed by the court, and that the plan will be confirmed within a reasonable period of time. Again, the concern is that section 442 may be too inflexible and could be used by some creditors to obtain leverage over other creditors,[202] or the case could be converted

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of Kenneth Klee, National Bankruptcy Conference).

196 S. 256, § 411.

197 S. 256, § 441.

198 S. 256, § 417.

199 Letter from Peggy Taylor, Director of Legislation, AFL-CIO, to the Honorable Henry J. Hyde, Chair, House Comm. on the Judiciary (Apr. 20, 1999).

200 The value to the estate of retaining the ability to assign certain leases is often a significant issue in determining which leases to assume or reject because it impacts upon the ability to pay other creditors. It should also be noted that the lessor already is entitled to get paid post-petition rent for the use of the property – the debtor is not using it for free.

201 In re Klein Sleep Prods., 78 F.3d 18, 22-24 (2d. Cir. 1996) (holding that bankruptcy practice requires that the courts treat the breach of the lease as a cost of administering the estate).

202 National Bankruptcy Conference, Report on H.R. 2415 [hereinafter Bankruptcy Report].

to chapter 7 when it may have successfully reorganized, costing jobs and sacrificing going concern value for the creditors and the estate.

IV. TAX PROVISIONS

The Bankruptcy Code seeks to effectuate a delicate balance between the rights of the Internal Revenue Service and state tax agencies to the repayment of any taxes, interest, and penalties owed them, and the rights of other creditors and the ability of individuals and corporations to be financially rehabilitated for the benefit of all parties. Title VII of the bill, on balance, manifests a strong preference for the IRS and other taxing authorities to the detriment of other participants in the bankruptcy system. Concerns have been expressed that, not only does S. 256 generally enhance the rights and position of the IRS and state authorities in bankruptcy, but the bill grants the IRS certain rights in bankruptcy cases that it does not enjoy outside of bankruptcy, and vests the IRS with new enforcement powers that ordinary creditors do not posses.[203] Of particular concern is the fact that the bill varies in many significant respects from the nonpartisan, and often unanimous, recommendations of the Bankruptcy Commission and its Tax Advisory Committee.

Title VII of S. 256 deals with the treatment of tax debts owed to the government by a debtor. It is ironic that the bill, whose sponsors have normally taken such an anti-tax posture on most issues, not only uses the IRS collection standards for the means test but also presses for changes to the Bankruptcy Code that favor governmental collections over the rights of debtors and private sector creditors.

Arguably one of the bill's most important provisions affecting business bankruptcies appears in Section 708 of Title VII. This section provides that a corporation will not be discharged from a tax or customs duty where the debtor made a fraudulent return or willfully attempted to evade or defeat the tax or duty. More significantly, by referencing any debt in section 523(a)(2) of the Code, the provision even would encompass claims that were fraudulently incurred that are *not* tax claims. In its critique of section 708, the National Bankruptcy Conference wrote:

> "A rule such as the one proposed in section 708 advantages one creditor at the expense of others. It is a recipe for certain mischief, especially in large reorganizations. There is no public policy reason to grant this kind of leverage to some creditors as the purpose in making these assertions transparently will likely be to obtain a better deal that other creditors."[204]

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[203] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 337 (Mar. 18, 1999). (written statement of Paul Asofsky, Chair, Task Force on the Tax Recommendations of the National Bankruptcy Review Commission of the American Bar Association's Tax Section).

[204] Bankruptcy Report, *supra* note 202, at 16.

In addition, Paul Asofsky, who served as the Chair of the Task Force on the Tax Recommendations of the National Bankruptcy Review Commission of the American Bar Association's Tax Section, testifying about H.R. 3150 on behalf of the American Bar Association's Section on Taxation, observed that: "[T]here are many provisions in this legislation with which we agree as a matter of principle, but the specific provisions are either ambiguously drafted or cut against the grain of the principal proposal, causing us to oppose what should be noncontroversial proposals."[205]

Mr. Asofsky provided a somewhat more detailed discussion of his concerns in a letter to the Subcommittee's Ranking Member.[206] Section 704 of S. 256 provides for a significantly higher uniform interest rate to be applied to tax claims in a bankruptcy case. The Tax Advisory Committee, which included governmental representatives, concluded that the rate for all types of tax claims should be the regular tax deficiency rate for federal income tax purposes. The bill, however, provides that the rate shall be determined by applicable nonbankruptcy law. Of greater concern, local governments can set their own interest rates, many of which are substantially higher than either of the IRS rates.[207]

Section 707 severely limits the broader discharge available to debtors in chapter 13. It would prevent a debtor from discharging certain tax debts, which is now permitted in chapter 13, but not in chapter 7. Eliminating the benefit of the superdischarge also eliminates the single greatest incentive for an individual debtor to choose chapter 13. As Mr. Asofsky observed,

> [T]he problem faced by many taxpayers who are delinquent in their obligations is that the IRS standard allowances for installment payment agreements[208] clearly do not leave many taxpayers with the minimum amounts necessary to provide for basic necessities, and so called "offers in compromise" are very difficult to obtain. Thus, for the most desperate of taxpayers, the chapter 13 superdischarge affords a safety net which is the only thing that provides them with the possibility of living somewhat of a normal life in dignity . . . elimination of the chapter 13 superdischarge would be devastating to large numbers of unfortunate individual debtors.[209]

Section 717 requires disclosure of the tax consequences of a chapter 11 plan of reorganization. Although originally an uncontroversial idea, the bill adds extra requirements that will likely cause confusion and may be impossible for debtors to comply with fully. The section

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[205] *Hearing on Consumer Bankruptcy Issues in H.R. 3150, the "Bankruptcy Reform Act of 1999," Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. 337 (Mar. 18, 1999). *March 18, 1999 House Judiciary Committee Hearing* (written statement of Paul Asofsky, Chair, Task Force on the Tax Recommendations of the National Bankruptcy Review Commission of the American Bar Association's Tax Section).

[206] Letter from Paul Asofsky to the Honorable Jerrold Nadler, Ranking Member, House Subcomm. on Commercial and Admin. Law (Feb. 5, 1999) [hereinafter Asofsky Letter].

[207] *Id.* at 3S4.

[208] These are the same standards used in the means test in section 102 of S. 256.

[209] Asofsky Letter, *supra* note 206, at 4.

now requires "a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interest in the case." The use of a vague term such as "discussion" – although an improvement over the requirement in the earlier version of a "*full* discussion" – will likely lead to extensive litigation as these statements are scrutinized. In some instances, the precise tax consequences of a plan at all levels of government, and for a "typical" holder of claim, may be difficult to produce with great precision.[210]

Finally, section 718 requires that a debtor actually have commenced an action against the taxing authority to determine the amount of a disputed tax before a setoff can be prevented. Absent such an action by the debtor, a governmental entity generally is free to "setoff" any pre-petition refund with a liability. The Advisory Committee had recommended that such setoff should only be permitted in cases where the liability was undisputed. The bill goes much further and to the disadvantage of the debtor and other, non-governmental creditors.

V. CORRUPTION OF THE BANKRUPTCY SYSTEM

Although the legislation purports to wring fraud and abuse from the bankruptcy system, there are a number of provisions that will open the door to further abuse by certain parties.

Section 324 of the bill would overturn the result in the *Merry-go-Round* case in which the accounting firm of Ernst and Young was held liable for fraud, fraudulent concealment, and negligence/malpractice for its conduct while serving as restructuring accountants and business advisors in the Merry-go-Round bankruptcy. The suit was brought in the Circuit Court for Baltimore City, but Ernst & Young attempted to move the case to the bankruptcy court. The case was remanded back to state court and the remand was ultimately upheld by the District Court.[211] Faced with a jury trial in state court, Ernst & Young ultimately settled the case with the trustee for $185 million.

The import of the *Merry-Go-Round* case is the issue of holding professionals, such as accounting firms, accountable for their actions in a bankruptcy case. As professionals, they are paid by funds from the estate before other creditors. They have a duty to the estate and the creditors. When they violate that duty, they can be denied fees by the bankruptcy court, or they may face an action for damages. Damages paid to the trustee are made available to the creditors.

This change in the law was inserted for the express purpose of insulating accountants and other professionals from facing the consequences of their wrongdoing. At a time when public policy is moving in the direction of greater accountability, there is no excuse for this change.

Section 414 would relieve investment bankers of the duty of being disinterested persons before they can be retrained as professionals by the trustee. The disinterestedness standard,

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[210] *Id.* at 5S6.

[211] In re: Merry-Go-Round Enterprises, Inc. (Ernest & Young, LLP v. Devan), 222 B.R. 254, 259 (D. Md. 1998).

which has been in existence since 1938, protects the estate from conflicts of interest by professionals in the case. Judge Edith Jones of the U.S. Court of Appeals for the Fifth Circuit has written, "such a standard can alone protect integrity in the bankruptcy process. If professionals who have previously been associated with the debtor continue to work for the debtor during a bankruptcy case, they will often be subject to conflicting loyalties that undermine their foremost fiduciary duty to the creditors. Strict disinterestedness, required by current law, eliminates such conflicts or potential conflicts . . . . Section 414, in removing investment bankers from a rigorous standard of disinterestedness, is out of character with the rest of this important legislation, however, and it should be eliminated."[212]

Section 102 relieves certain creditors and their attorneys from penalties prescribed in the bill even if they violate Bankruptcy Rule 9011. As discussed earlier, there is never a justification for violating Bankruptcy Rule 9011. Granting such an exception would only encourage inexcusable abuse of the process. Moreover, because this exception is embedded in the attorney sanctions portion of the individual debtor provisions of this bill, it would open the door to creditors abusing the most vulnerable debtors with impunity. There are many instances in which this legislation makes such abuse possible. Enshrining this sort of exemption in the law exemplifies the dangerous distortion of the bankruptcy system this bill represents.

CONCLUSION

The Bankruptcy Code has proven to be a model of pragmatism and equity at law. The proposed legislation would undermine both of those important principles. It may well be that, in the years to come, many of the same interest groups now clamoring for this legislation will come to regret the inefficiencies, uncertainties, and distortions it will inflict on the bankruptcy system. While the Bankruptcy Code could clearly benefit from reforms and modernization, indeed this legislation contains many provisions that are both beneficial and uncontroversial, much if it is unnecessary and harmful to debtors, creditors, and the economy.

We respectfully dissent, and urge our colleagues to reject S. 256.

John Conyers, Jr.
Howard L. Berman
Jerrold Nadler
Robert C. Scott
Melvin Watt
Zoe Lofgren
Sheila Jackson Lee
Maxine Water
Martin Meehan
William D. Delahunt
Anthony Weiner
Linda Sanchez
Chris Van Hollen

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[212] Letter from the Hon. Edith H. Jones, Judge for the Fifth Circuit Court of Appeals, to Hon. F. James Sensenbrenner, Chairman, House Judiciary Committee (Hon. Edith H. Jones) (March 11, 2003).